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TAX EVASION, DRUG TRAFFICKING AND MONEY LAUNDERING AS THEY INVOLVE FINANCIAL INSTITUTIONS

#228

OMPLETED
1276

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 1367

A BILL TO AMEND CHAPTER 35 OF TITLE 12, CHAPTERS 95 AND 119 OF TITLE 18, CHAPTER 53 OF TITLE 31 OF THE UNITED STATES CODE RELATING TO MONEY LAUNDERING

H.R. 1474

A BILL TO AMEND TITLE 18 OF THE UNITED STATES CODE TO PROHIBIT CERTAIN METHODS OF CONCEALING THE PROCEEDS OF CRIME, AND FOR OTHER PURPOSES

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A BILL TO STRENGTHEN CERTAIN CURRENCY REPORTING REQUIREMENTS

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H.R. 4280

A BILL TO AMEND TITLE 31, UNITED STATES CODE, TO ESTABLISH NEW RECORDKEEPING AND REPORTING REQUIREMENTS IN ORDER TO COMBAT MONEY LAUNDERING, AND FOR OTHER PURPOSES

H.R. 4573

A BILL ENTITLED THE "MONEY LAUNDERING PREVENTION ACT OF 1986"

APRIL 16, 17, 29; AND MAY 14, 1986

Serial No. 99-80

ORIGINAL

Printed for the use of the Committee on Banking, Finance and Urban Affairs

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TAX EVASION, DRUG TRAFFICKING AND MONEY LAUNDERING AS THEY INVOLVE FINANCIAL INSTITUTIONS

WEDNESDAY, APRIL 16, 1986

House of Representatives,
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance,
Committee on Banking, Finance and Urban Affairs,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of the subcommittee) presiding.

Present: Chairman St Germain; Representatives Annunzio, Barnard, Kanjorski, Wylie, McKinney, Parris, Wortley, and Bartlett.

Also present: Representative Esteban E. Torres of the full committee.

Chairman St Germain. The subcommittee will come to order.

Today the subcommittee begins hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers, and money launderers.

Following the committee's hearing last April on the *Bank of Boston* case, and the bank's guilty plea to Bank Secrecy Act violations, scores of banks have approached the Treasury Department to work out an agreement for similar violations, a process which has been described by some as "Dial-a-Confession." Approximately 65 bank holding companies or banks are under consideration for possible civil penalties. Since the Bank of Boston plea, 14 banks have been fined in amounts ranging from $121,000 to the largest fine of $4.75 million, imposed on the Bank of America, and it is anticipated that many more will be announced over the next several months.

Subsequent to last year's hearings, Mr. Wylie and I introduced by request H.R. 2785, the administration's "Money Laundering and Related Crimes Act of 1985." Since then, other bills dealing with this problem have been introduced and have been referred to the Banking Committee.

The purpose of these hearings are to, No. 1, review the regulatory actions that the banking and other related agencies have taken since last April to ensure that the financial institutions of this Nation are in compliance with the reporting requirements and other provisions of the Bank Secrecy Act; and No. 2, to seek legislative means, if necessary to help law enforcement efforts in stopping criminals from using our Nation's financial system to carry out their illegal activities. We must be ever mindful, however, that an equitable balance be maintained between attaining the goal and preserving the financial privacy and other precious rights of individuals.

Fifteen years ago, the Bank Records and Foreign Transactions Act was enacted into law. Titles I and II of the law constitute what is commonly known as the Bank Secrecy Act. The primary purpose of the reporting requirements of that act is to identify the sources, the amount, and movements of U.S. currency which is transported into or out of the country, or deposited in financial institutions in order to give law enforcement officials the basic tools to detect and investigate criminal tax and regulatory violations.

The Bank Secrecy Act, together with other titles of the Bank Records and Foreign Transactions Act, is a product of the House Banking Committee. As passed by our committee, the legislation was designed to stop the use of secret bank accounts for illegal practices such as the evasion of taxes, the taking over of legitimate businesses by organized crime, the financing of narcotics traffic, and other illegal purposes. It should be emphasized that while a great deal of our efforts will be spent on issues involving money laundering as they relate to drug trafficking, we should be mindful that the Bank Secrecy Act was also intended to cover, as well, other forms of illegal activity, including tax evasion.

Also, while recently the focus of attention has been and continues to be on compliance with the reporting provisions by financial institutions, we should be aware that the original purpose of the Bank Secrecy Act was also to catch those individuals who use financial institutions as a means to keep from the Federal Government sources of taxable income.

There is no question that money laundering is now more pervasive than it ever was, and that it is becoming more difficult for law enforcement officials to connect the money laundering scheme per se with the crime from which such funds are obtained. Criminal elements in our society are becoming more sophisticated in their illegal operations. This sophistication has led to the creation of a new position, the professional money launderer.

The subcommittee intends to pursue these actions to learn more about the sophistication of money laundering and the schemes developed by so-called professional money launderers.

As a matter of fact, we have with us today an individual who was a money launderer. His identity was purposely not disclosed in the notice of hearings recently announced, in order to protect him from undue publicity which might have posed some difficulties for him.

In analyzing the various legislative proposals, the subcommittee will revisit not only the Bank Secrecy Act, but will also review the Right to Financial Privacy Act, the Change in Bank Control Act, and other provisions of FIRICA, otherwise known as the Safe Banking Act of 1978.

Tomorrow, we will hear from the Department of the Treasury, the civil side of the IRS and the banking regulators, who will review these various issues with us.

Today, it is my pleasure to introduce to you our lead-off witness in these hearings, the Honorable J.J. Pickle. Mr. Pickle, a senior

Member of the House Ways and Means Committee, has today introduced a bill that has been referred to this committee, the purpose of which is to deal with the subject of money laundering and seizure and forfeiture provisions of title 31 of the Bank Secrecy Act.

Following Mr. Pickle's testimony, we will hear from Mr. Herbert Friedberg, who will tell us about his experiences as a money launderer. He will be followed by Mr. Richard Wassenaar, Assistant Commissioner—Criminal Investigation of the Internal Revenue Service, who will brief us on the various offshore tax shelter schemes, the various money laundering schemes which have been discovered and successfully prosecuted by the IRS and the Department of Justice, and the problems law enforcement agencies still encounter in tracking down this type of criminal activity.

I would like to also mention the fact that, as I stated, Mr. Wylie and I have cosponsored the administration bill. Legislation has also been introduced, that I have cosponsored with Mr. Torres. Other legislation has been introduced by Mr. McCollum, who also has worked on this in the Judiciary Committee. Mr. Wortley of New York has also been very active in this area and has introduced legislation, and Congressman LaFalce on the committee has also had previous interest in it. And of course, we will be hearing from Mr. Pickle.

[The texts of H.R. 1367; H.R. 1474; H.R. 1945; H.R. 2785; H.R. 3892; H.R. 4280; and H.R. 4573, all related to these hearings, follow:]

I

99TH CONGRESS
1ST SESSION

H. R. 1367

To amend chapter 35 of title 12, chapters 95 and 119 of title 18, chapter 53 of title 31 of the United States Code relating to money laundering.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 28, 1985

Mr. MCCOLLUM introduced the following bill; which was referred jointly to the Committees on the Judiciary and Banking, Finance and Urban Affairs

JANUARY 10, 1986

Additional sponsors: Mr. WOLF, Mr. KANJORSKI, Mr. LAGOMARSINO, Mr. YOUNG of Florida, Mr. FAUNTROY, Mr. MARTINEZ, Mr. GOODLING, Mr. SWINDALL, Mr. MAZZOLI, Mr. LUNGREN, Mr. SOLOMON, and Mr. KOLTER

A BILL

To amend chapter 35 of title 12, chapters 95 and 119 of title 18, chapter 53 of title 31 of the United States Code relating to money laundering.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Money Laundering Act of 1985".

TITLE I—MONEY LAUNDERING OFFENSE

SEC. 101. (a) Chapter 95 of title 18, United States Code, is amended by adding the following new section:

"§ 1956. Laundering of monetary instruments

"(a) Whoever conducts or causes to be conducted a transaction or series of transactions involving one or more monetary instruments in, through, or by a financial institution which is engaged in, or the activities of what affect, interstate commerce, or attempts so to do—

"(1) with intent to promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity; or

"(2) with knowledge or reason to know that such monetary instruments represent income derived, directly or indirectly, from any unlawful activity, or the proceeds of such income,

shall be fined not more than $250,000 or twice the value of the monetary instruments, whichever is greater, or imprisoned not more than five years, or both, for the first such offense, and shall be fined not more than $1,000,000 or five times the value of the monetary instruments, whichever is greater, or imprisoned not more than ten years, or both, for each such offense thereafter.

"(b) As used in this section—

"(1) the term 'conducts' includes, but is not limited to, initiating, concluding, or participating in conducting, initiating, or concluding a transaction;

"(2) the term 'transaction' includes, but is not limited to, a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected;

"(3) the term 'monetary instruments' means monetary instruments as defined in section 203(l) of the Currency and Foreign Transactions Reporting Act, as revised (31 U.S.C. 5312(a)(3));

"(4) the term 'financial institution' means financial institution as defined in section 203(e) of the Currency and Foreign Transactions Reporting Act, as revised (31 U.S.C. 5312(a)(2)); and

"(5) the term 'unlawful activity' means any act or acts constituting—

"(A) a pattern of racketeering activity or collection of unlawful debt, as those terms are defined in section 901(a) of the Organized Crime Control Act of 1970 (18 U.S.C. 1961–1968);

"(B) a continuing criminal enterprise, as that term is defined in section 408 of the Controlled Substances Act (21 U.S.C. 848);

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"(C) an offense under any of the following provisions of title 18, United States Code: section 201 (relating to bribery), section 224 (relating to bribery in sporting contests), sections 471–473 (relating to counterfeiting), section 659 (relating to theft from interstate shipment) if the offense is felonious, section 664 (relating to embezzlement from pension and welfare funds), sections 891–894 (relating to extortionate credit transactions), section 1084 (relating to the transmission of gambling information), section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), sections 1461–1465 (relating to obscene matter), section 1503 (relating to obstruction of justice), section 1510 (relating to obstruction of criminal investigations), section 1511 (relating to obstruction of State or local law enforcement), section 1951 (relating to interference with commerce by threats or violence), section 1952 (relating to racketeering enterprises), section 1953 (relating to interstate transportation of wagering paraphernalia), section 1954 (relating to unfair welfare fund payments), section 1955 (relating to prohibition of illegal gambling businesses), sections 2314 and 2315 (relating to interstate transportation of stolen property), sections 2341–2346 (relating to trafficking in contraband cigarettes), or sections 2421–2424 (relating to white slave traffic);

"(D) an offense under title 29, United States Code, section 186 (relating to restrictions on payments and loans to labor organizations) or section 501(c) (relating to embezzlement from union funds); or

"(E) an offense involving the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in narcotic or other dangerous drugs, punishable under any law of the United States.

"(c) The provisions of this section shall be liberally construed to effectuate its remedial purpose.

"(d) Nothing in this section shall supersede any provision of Federal, State or other law imposing criminal penalties or affording civil remedies in addition to those provided for in this section.

"(e) Violations of this section shall be investigated by the Federal Bureau of Investigation, the Drug Enforcement Administration, and the Internal Revenue Service, as appropriate.

"(f) There is extraterritorial jurisdiction over the conduct prohibited by this section.".

(b) The table of sections at the beginning of chapter 95 of title 18 is amended by adding at the end the following new item: "1956. Laundering of monetary instruments".

TITLE II—CURRENCY AND FOREIGN TRANSACTIONS REPORTING ACT AMENDMENTS

SEC. 201. Section 5318 of title 31, United States Code, is amended—

(1) by inserting "(a)" after "SEC. 5318.";

(2) by inserting ", except as provided in subsection (c)" before the semicolon at the end of paragraph (1);

(3) by striking out "and" at the end of paragraph (2);

(4) by redesignating paragraph (3) as paragraph (4);

(5) by inserting after paragraph (2) the following:

"(3)(A) examine any books, papers, records, or other data of domestic financial institutions pursuant to the recordkeeping and reporting requirements under this subchapter;

"(B) summon an officer or employee of a financial institution, or any person having possession, custody, or care of the reports or records required under the subchapter, to appear before the Secretary of the Treasury or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give testimony, under oath, as may be relevant or material to such inquiry; and

"(C) take such testimony of the officer, employee, or person having possession of the relevant reports or records, under oath, as may be relevant or material to such inquiry; and"; and

(6) by adding at the end thereof the following:

"(b) The purposes for which the Secretary of the Treasury may take any action described in paragraph (3) of subsection (a) include the purpose of investigating any offense connected with the administration or enforcement of this subchapter, section 21 of the Federal Deposit Insurance Act, section 411 of the National Housing Act, or chapter 2 of Public Law 91-508.

"(c)(1) The Secretary of the Treasury may not delegate the powers conferred by subsection (a)(3) to an appropriate supervising agency.

"(2) A summons may be issued under subsection (a)(3)(B) only by, or with the approval of, the Secretary of the Treasury or a supervisory level delegate of the Secretary of the Treasury.".

SEC. 202. Section 5319 of title 31, United States Code, is amended by inserting before the period at the end of the first sentence the following: ", or when the Secretary has reason to believe that making such information available to the agency would further or facilitate the exercise of the Secretary's supervisory or regulatory functions under this subchapter".

SEC. 203. Section 5312(a)(5) of title 31, United States Code, is amended to read as follows:

"(5) 'United States' means the States of the United States, the District of Columbia, and, when the Secretary prescribes by regulation, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, the Northern Marianas, American Samoa, the Trust Territory, any other territory or possession of the United States, or a military or diplomatic establishment.".

TITLE III—WIRETAP AMENDMENTS

SEC. 301. Section 2516 of title 18, United States Code, is amended—

(1) by inserting "section 1956 (laundering of monetary instruments)," after "section 1955 (prohibition of business enterprises of gambling)," in subsection (c);

(2) by striking out "or" at the end of subsection (g);

(3) by redesignating subsection (h) as subsection (i); and

(4) by inserting the following new subsection after subsection (g):

"(h) a violation of section 5322 of title 31, United States Code (dealing with the reporting of currency transactions); or".

TITLE IV—RIGHT TO FINANCIAL PRIVACY ACT AMENDMENTS

SEC. 401. (a) Subsection (c) of section 1103 of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3403(c)) is amended to read as follows:

"NOTIFICATION OF EXISTENCE, AND DISCLOSURE, OF RELEVANT INFORMATION IN RECORDS; FEDERAL PREEMPTION

"(c) Nothing in this chapter shall preclude any financial institution, or any officer, employee, or agent of a financial institution, from notifying a Government authority that such institution, or officer, employee, or agent has information which it believes may be relevant to a possible violation of any statute or regulation, and thereafter disclosing such information to that Government authority, regardless of whether a subpoena, summons, search warrant, or formal written request has been issued under the provisions of this chapter. The provisions of this subsection and any regulations promulgated thereunder shall preempt any provision of any constitution, law, or regulation of any State or political subdivision thereof, as well as any administrative or judicial interpretation of such provision, that is not identical to the provisions of this subsection and regulations thereunder, and that is more restrictive of disclosure to a Government authority concerning a possible violation of any statute or regulation than the provisions of this subsection and regulations promulgated thereunder.".

(b) Subsection (c) of section 1117 of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3417(c)) is amended to read as follows:

"GOOD-FAITH DEFENSE

"(c) Any financial institution, or officer, employee, or agent thereof, making a disclosure of the financial records of a customer, or information contained in such records, pursuant to this chapter in good-faith reliance upon a certificate by any Government authority, or in good-faith belief that such records or information may be relevant to a possible violation of any statute or regulation, shall not be liable to the customer for such disclosure or for any failure to notify the customer of such disclosure.".

○

99TH CONGRESS
1ST SESSION

H. R. 1474

To amend title 18 of the United States Code to prohibit certain methods of concealing the proceeds of crime, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MARCH 7, 1985

Mr. HUGHES introduced the following bill; which was referred jointly to the Committees on the Judiciary and Banking, Finance and Urban Affairs

---

A BILL

To amend title 18 of the United States Code to prohibit certain methods of concealing the proceeds of crime, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Money Laundering Control Act of 1985".

SEC. 2. MONEY LAUNDERING OFFENSE.

(a) IN GENERAL.—Chapter 95 (relating to racketeering) of title 18, United States Code, is amended by adding at the end thereof the following new section:

“§ 1956. Money laundering

“(a) Offense.—Whoever knowingly engages or attempts to engage in a financial transaction in criminally derived property shall be punished as provided in subsection (b).

“(b) Punishment.—(1) Except as provided in paragraph (2), the punishment for an offense under this section is—

“(A) a fine not more than $1,000,000 or imprisonment for not more than 5 years, or both, if the offender is an individual; and

“(B) a fine of not more than $5,000,000, if the offender is a person other than an individual.

“(2) The court may impose an alternate fine to that imposable under paragraph (1) of not more than twice the amount of the funds or monetary instrument in such financial transaction.

“(c) Extraterritorial Jurisdiction.—There is extraterritorial jurisdiction over an offense under this section.

“(d) Definitions.—As used in this section—

“(1) the term ‘financial transaction’ means the deposit, withdrawal, transfer, or exchange, of funds or a monetary instrument (as defined for the purposes of subchapter II of chapter 53 of title 31) by, through, or to a financial institution (as defined in section 5312(a)(2) of title 31); and

"(2) the term 'criminally derived property' means any property constituting, or derived from, proceeds obtained, directly or indirectly, from a criminal offense that is listed in section 1961(1) of this title.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 95 (relating to racketeering) of title 18, United States Code, is amended by adding at the end the following new item:

"1956. Money laundering.".

SEC. 3. INDIVIDUAL APPROVAL OF APPLICATION OF EXEMPTIONS.

(a) IN GENERAL.—Section 5318 of title 31, United States Code, is amended by adding at the end of paragraph (3) thereof the following new sentence: "A person shall not qualify for an exemption prescribed under this paragraph until the Secretary, upon application by such person, determines such person is qualified for such exemption.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to all exemptions under section 5318 of title 31, United States Code, after the 90th day after the date of the enactment of this Act.

SEC. 4. APPLICATION OF CERTAIN REPORTING RULES TO WIRE AND OTHER ELECTRONIC TRANSFERS.

Section 5316(a)(1) of title 31, United States Code is amended by inserting "transfers funds by wire or other electronic means, or" after "(1)".

SEC. 5. COMPLIANCE ADMINISTRATION.

Section 5318 of title 31, United States Code, is amended—

(1) by inserting "(a)" before "The Secretary of the Treasury", and

(2) by adding at the end of such section the following new subsection:

"(b) It shall be the duty of each such supervising agency to exercise the authority delegated under subsection (a)(1) of this section in the course of each examination such agency may make of a regulated entity for purposes of carrying out provisions of law other than this subchapter.".

SEC. 6. FOREIGN TRANSACTIONS AMENDMENT.

Section 5316(a)(1) of title 31, United States Code, is amended—

(1) by striking out "or attempts to transport or have transported,"; and

(2) by inserting ", is about to transport," after "transports".

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99TH CONGRESS
1ST SESSION

H. R. 1945

To strengthen certain currency reporting requirements.

IN THE HOUSE OF REPRESENTATIVES

APRIL 3, 1985

Mr. HUBBARD introduced the following bill; which was referred jointly to the Committees on Banking, Finance and Urban Affairs and the Judiciary

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A BILL

To strengthen certain currency reporting requirements.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Drug Money Seizure Act".

TITLE I—CURRENCY REPORTING AMENDMENTS

SEC. 101. SHORT TITLE.

This title may be cited as the "Currency Reporting Amendments of 1985".

SEC. 102. ADDITIONAL ENFORCEMENT POWERS.

Section 5318 of title 31, United States Code, is amended—

(1) in paragraph (1), by inserting before the semicolon at the end thereof the following: ", except as provided in subsection (c)";

(2) in paragraph (2), by striking out "and" at the end thereof;

(3) by redesignating paragraph (3) as paragraph (4);

(4) by inserting after paragraph (2) the following:

"(3)(A) examine any books, papers, records, or other data of domestic financial institutions pursuant to the recordkeeping and reporting requirements under this subchapter;

"(B) summon an officer or employee of a domestic financial institution, or any person having possession, custody, or care of the reports or records required under the subchapter, to appear before the Secretary of the Treasury or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant material to such inquiry; and

"(C) take such testimony of the officer, employee, or person having possession of the relevant reports or records, under oath, as may be relevant or material to such inquiry; and";

(5) by inserting "(a)" before "The Secretary of the Treasury"; and

(6) by adding at the end thereof the following:

"(b) The purposes for which the Secretary of the Treasury may take any action described in subsection (a)(3) include the purpose of investigating any offense connected with the administration or enforcement of this subchapter, section 21 of the Federal Deposit Insurance Act, section 411 of the National Housing Act, or chapter 2 of Public Law 91-508.

"(c)(1) The Secretary of the Treasury may delegate the powers conferred by subsection (a)(3) to an appropriate supervising agency.

"(2) A summons may be issued under subsection (a)(3)(B) only by, or with the approval of, the Secretary of the Treasury or a supervisory level delegate of an appropriate Treasury bureau.".

SEC. 103. INCREASED CIVIL PENALTIES.

Section 5321(a) of title 31, United States Code, is amended—

(1) by striking out the first sentence of paragraph (1) and inserting in lieu the following:

"A domestic financial institution, and a partner, director, officer, or employee of a domestic financial institution, willfully

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violating this subchapter or a regulation prescribed under this subchapter (except section 5315 of this title or a regulation prescribed under section 5315) or causing such a violation is liable to the United States Government for a civil penalty of not more than—

"(A) the amount of the transaction where the violation involves a transaction reporting requirement; or

"(B) $10,000 for any other violation."; and

(2) by adding at the end thereof the following:

"(4) A person willfully violating the provisions of section 5314 of this title or of a regulation prescribed under section 5314 is liable to the United States Government for a civil penalty of not more than the amount of the foreign transaction or foreign account involved in the violation.".

SEC. 104. DEFINITIONS.

Section 5312(a)(5) of title 31, United States Code, is amended to read as follows:

"(5) 'United States' means the States of the United States, the District of Columbia, and, when the Secretary prescribes by regulation, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, the Northern Marianas, American Samoa, the Trust Territory, any other territory or possession of the United States, or a military or diplomatic establishment.".

TITLE II—MONEY LAUNDERING

SEC. 201. SHORT TITLE.

This title may be cited as the "Money Laundering Crimes Act".

SEC. 202. TITLE 18 AMENDMENT.

(a) IN GENERAL.—Chapter 95 of title 18, United States Code, is amended by adding at the end thereof the following new section:

"§1956. Laundering of monetary instruments

"(a) OFFENSE.—Whoever conducts or causes to be conducted a transaction or series of transactions involving one or more monetary instruments in, through, or by a financial institution which is engaged in, or the activities of which affect, interstate commerce, or attempts so to do—

"(1) with intent to promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity; or

"(2) with knowledge or reason to know that such monetary instruments represent income derived, directly or indirectly, from any unlawful activity, or the proceeds of such income,

shall be fined not more than $250,000 or twice the value of the monetary instruments, whichever is greater, or imprisoned not more than ten years, or both, for the first such

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offense, and shall be fined not more than $1,000,000 or five times the value of the monetary instruments, whichever is greater, or imprisoned not more than twenty years, or both, for each such offense thereafter.

"(b) DEFINITIONS.—As used in this section—

"(1) the term 'conducts' includes initiating, concluding, or participating in conducting, initiating, or concluding a transaction;

"(2) the term 'transaction' includes a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected;

"(3) the term 'monetary instruments' means monetary instruments as defined in section 5312(a)(3) of title 31;

"(4) the term 'financial institution' means financial institution as defined in section 5312(a)(2) of title 31; and

"(5) the term 'unlawful activity' means any act or acts constituting—

"(A) a pattern of racketeering activity or collection of unlawful debt, as those terms are defined for the purposes of chapter 96 of this title;

"(B) a continuing criminal enterprise, as that term is defined in section 408 of the Controlled Substances Act (21 U.S.C. 848);

"(C) an offense under any of sections 201 (relating to bribery), 224 (relating to bribery in sporting contests), 471–473 (relating to counterfeiting), 659 (relating to theft from interstate shipment) if the offense is felonious, 664 (relating to embezzlement from pension and welfare funds), 891–894 (relating to extortionate credit transactions), 1084 (relating to the transmission of gambling information), 1341 (relating to mail fraud), 1343 (relating to wire fraud), 1461–1465 (relating to obscene matter), 1503 (relating to obstruction of justice), 1510 (relating to obstruction of criminal investigations), 1511 (relating to obstruction of State or local law enforcement), 1951 (relating to interference with commerce by threats or violence), 1952 (relating to racketeering enterprises), 1953 (relating to interstate transportation of wagering paraphernalia), 1954 (relating to unfair welfare fund payments), 1955 (relating to prohibition of illegal gambling businesses), 2314 or 2315 (relating to interstate transportation of stolen property), 2341–2346 (relating to trafficking in contraband cigarettes), or 2421–2424 (relating to white slave traffic) of this title;

"(D) an offense under section 302 (relating to restrictions on payments and loans to labor organizations) of the Labor-Management Relations Act, 1947 (29 U.S.C. 186), or section 501(c) (relating to embezzlement from union funds) of the Labor-Management Reporting and Disclosure Act of 1959 (29 U.S.C. 501(c)); or

"(E) an offense involving the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in narcotic or other dangerous drugs, punishable under any law of the United States.

"(c) EFFECT ON OTHER LAW.—Nothing in this section shall supersede any provision of Federal, State, or other law imposing criminal penalties or affording civil remedies in addition to those provided for in this section.

"(d) INVESTIGATIVE AUTHORITY.—Violations of this section shall be investigated by the Federal Bureau of Investigation, the Drug Enforcement Administration, and the Internal Revenue Service, as appropriate.

"(e) EXTRATERRITORIAL JURISDICTION.—There is extraterritorial jurisdiction over the conduct prohibited by this section.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 95 of title 18, United States Code, is amended by adding at the end the following new item:

"1956. Laundering of monetary instruments".

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99TH CONGRESS
1ST SESSION

H. R. 2785

To combat money laundering.

IN THE HOUSE OF REPRESENTATIVES

JUNE 18, 1985

Mr. ST GERMAIN (for himself and Mr. WYLIE) (by request) introduced the following bill; which was referred jointly to the Committees on Banking, Finance and Urban Affairs and the Judiciary

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A BILL

To combat money laundering.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this act may be cited as the "Money Laundering and Related Crimes Act of 1985."

SEC. 2. (a) Chapter 95 of title 18, United States Code, is amended by adding at the end thereof the following new section:

"§ 1956. Laundering of monetary instruments

"(a) Whoever conducts, causes to be conducted, or attempts to conduct a transaction involving the movement of funds by wire or other electronic means or involving one or more monetary instruments, which in any way or degree affects interstate or foreign commerce, or conducts, causes to be conducted, or attempts to conduct such a transaction through or by a financial institution which is engaged in, or the activities of which affect, interstate or foreign commerce in any way or degree—

"(1) with the intent to promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity; or

"(2) knowing or with reckless disregard of the fact that such monetary instruments or funds represent the proceeds of, or are derived directly or indirectly from the proceeds of, any unlawful activity

shall be sentenced to a fine of not more than $250,000 or twice the value of the monetary instruments or wire transferred funds, whichever is greater, or imprisonment for not more than 20 years, or both.

"(b) Whoever conducts, causes to be conducted, or attempts to conduct a transaction described in subsection (a) is liable to the United States for a civil penalty of not more than the greater of—

(1) the value of the funds or monetary instrument or instruments involved in the transaction, or

(2) $10,000.

"(c) As used in this section—

"(1) the term 'conducts' includes but is not limited to initiating, concluding, or participating in initiating, or concluding a transaction;

"(2) the term 'transaction' includes but is not limited to a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes but is not limited to a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected;

"(3) the term 'monetary instruments' means coin or currency of the United States or of any other country, travelers' checks, personal checks, bank checks, money orders, investment securities in bearer form or otherwise in such form that title thereto passes upon delivery, and negotiable instruments in bearer form or otherwise in such form that title thereto passes upon delivery;

"(4) the term 'financial institution' has the definition given that term in 31 U.S.C. 5312(a)(2) and the regulations promulgated thereunder;

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"(5) the term 'unlawful activity' means any act or activity occurring in whole or in part in, or directed at, the United States and constituting an offense punishable by death or imprisonment for a term exceeding one year under the laws of the United States or any State of the United States in which the act or activity took place; and

"(6) the term 'reckless disregard' as used in paragraph (2) of subsection (a) means that the person is aware of a substantial risk that the monetary instruments or funds involved in the transaction represent the proceeds of, or are derived directly or indirectly from the proceeds of, any unlawful activity, but disregards the risk. A substantial risk means a risk (based on all the circumstances of the transaction including but not limited to the amount and type of funds or monetary instruments and the nature of the transaction) that is of such a nature and degree that to disregard it constitutes a gross deviation from the standard of care that a reasonable person would exercise in such a situation.

"(d) Nothing in this section shall supersede any provision of Federal, State, or other law imposing criminal penalties or affording civil remedies in addition to those provided for in this section.

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"(e) Violations of this section may be investigated by such components of the Department of Justice as the Attorney General may direct, and by such components of the Department of the Treasury as the Secretary of the Treasury may direct, as appropriate.

"(f) There is extraterritorial jurisdiction over the conduct prohibited by this section if:

"(1) the transaction was conducted or attempted with the intent to promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on of any unlawful activity, involving a violation of this title, a violation of title 26, a violation of the Controlled Substances Act (21 U.S.C. 801 et seq.), a violation of the Controlled Substances Import and Export Act (21 U.S.C. 951 et seq.), a violation of section 1 of the Act of September 15, 1980 (21 U.S.C. 955a), a violation of section 601 of the National Security Act of 1947 (50 U.S.C. 421), a violation of section 4 of Title I of the Internal Security Act of 1950 (50 U.S.C. 783), a violation of section 2 of the Act of August 1, 1956 (P.L. 84-893, 50 U.S.C. 851), or a violation of sections 224-227 of the Atomic Energy Act of 1954 (42 U.S.C. 2274-2277); or with knowledge of the fact that the monetary instruments or funds involved in the offense represent the proceeds of, or are derived directly or indirectly from the proceeds of, any such unlawful activity;

"(2) the conduct is by a United States person or, in the case of a non-United States person, the conduct occurs in part in the United States and;

"(3) the transaction or series of related transactions involves funds or monetary instruments of a value exceeding $10,000.".

(b) The table of sections at the beginning of chapter 95 of title 18 is amended by adding at the end the following new item: "1956. Laundering of monetary instruments".

SEC. 3. (a) Section 1113 of The Right to Financial Privacy Act of 1978 (Title XI of Public Law 95-630, 12 U.S.C. 3413) is amended by adding at the end thereof the following:

"(1) Nothing in this title shall apply when a financial institution or supervisory agency, or any officer, employee, or agent of a financial institution or a supervisory agency, provides to an agency of the United States financial records which such financial institution or supervisory agency has reason to believe may be relevant:

(1) to a possible violation of any law relating to crimes by or against financial institutions or supervisory agencies,

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(2) to a possible violation of the Controlled Substances Act (21 U.S.C. 801 et seq.), the Controlled Substances Import and Export Act (21 U.S.C. 951 et seq.), or sections 1 or 3 of the Act of September 15, 1980 (21 U.S.C. 955a and c), or

(3) to a possible violation of a provision contained in subchapter II of chapter 53 of title 31, United States Code, or of section 1956 of title 18, United States Code.".

(b) Subsection 1112(a) of the Right to Financial Privacy Act of 1978, (Title XI of Public Law 95-630, 12 U.S.C. 3412(a)) is amended to read as follows:

"(a) Nothing in this title shall apply when financial records obtained by an agency or Department of the United States are transferred to another agency or department if there is reason to believe that the records may be relevant to a matter within the jurisdiction of the receiving agency or department.".

(c) Subsection 1103(c) of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3403(c)) is amended by adding at the end thereof the following: "Such information may include the name or names of and other identifying information concerning the individuals and accounts involved in and the nature of the suspected illegal activity.".

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(d) Subsection 1117(c) of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3417(c)) is amended to read as follows:

"(c) Any financial institution, or officer, employee or agent thereof, making a disclosure of the financial records of a customer, or information contained in such records, pursuant to this chapter in good-faith reliance upon a certificate by any Government authority, or in good-faith belief that such records or information may be relevant to a possible violation of law in accordance with subsection 3413(1) or section 3403(c) of this title, shall not be liable to the customer for such disclosure or for any failure to notify the customer of such disclosure.".

(e) Subsections (b) and (c) of section 1112 of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3412) are repealed and subsections (d) and (e) of that section are redesignated subsections (b) and (c), respectively.

(f) Section 1120 of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3420) is amended by striking out paragraph (1) and redesignating paragraphs (2) through (4) and any reference thereto in such paragraphs as paragraphs (1) through (3), respectively.

(g) The Right to Financial Privacy Act of 1978 (12 U.S.C. 3401 et seq., is amended by adding at the end thereof the following new section 1123 (12 U.S.C. 3423):

"§ 3423. Preemption of State law

The provisions of this title and any regulations promulgated thereunder shall preempt any provision of any constitution, law, or regulation of any State or political subdivision thereof, as well as any administrative or judicial interpretation of such provision, that is not identical to the provisions of this title and regulations thereunder, and that is more restrictive of disclosure to a Government authority concerning a possible violation of any statute or regulation than the provisions of this title and regulations promulgated thereunder.".

SEC. 4. Rule 17(c) of the Federal Rules of Criminal Procedure is amended by adding at the end thereof the following:

"An attorney for the government may apply to the court for an order commanding the person to whom the subpoena is directed, for such period as the court deems appropriate, not to notify any other person of the existence of the subpoena. The court shall enter such an order if it determines that—(1) there is reason to believe that the books, records, documents, or other objects designated in the subpoena are relevant to a legitimate law enforcement proceeding; and (2) there is reason to believe that notification of the existence of the subpoena will result in: (A) endangering the life or physical safety of any individual; (B) flight from prosecution; (C) destruction of or tampering with evidence; (D) intimidation of potential witnesses; or (E) otherwise seriously jeopardizing an investigation or unduly delaying a trial.

SEC. 5. (a) Section 5318 of title 31, United States Code, is amended to read as follows:

"§ 5318. Compliance, exemptions, and summons authority

"(a) The Secretary of the Treasury may (except under section 5315 of this title and regulations prescribed under section 5315)—

"(1) delegate duties and powers under this subchapter to an appropriate supervising agency, except as provided in subsection (c);

"(2) require a class of domestic financial institutions to maintain appropriate procedures to ensure compliance with this subchapter and regulations prescribed under this subchapter;

"(3) examine any books, papers, records, or other data of domestic financial institutions relevant to the recordkeeping or reporting requirements of this subchapter;

"(4) summon a financial institution or an officer or employee of a financial institution, or a former officer or employee, or any person having possession, custody, or care of the reports and records required under this subchapter, to appear before the Secretary of the Treasury or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give testimony, under oath, as may be relevant or material to an investigation described in subsection (c).

"(5) prescribe an appropriate exemption from a requirement under this subchapter and regulations prescribed under this subchapter. The Secretary may revoke an exemption by actually or constructively notifying the parties affected. A revocation is effective during judicial review.

"(b) The purposes for which the Secretary of the Treasury may take any action described in paragraph (3) of subsection (a) include the purpose of civil and criminal enforcement of the provisions of this subchapter, section 21 of the Federal Deposit Insurance Act (12 U.S.C. 1829b), section 411 of the National Housing Act (12 U.S.C. 1730d), or chapter 2 of Public Law 91-508.

"(c) The purpose for which the Secretary of the Treasury may take any action described in paragraph (4) of subsection (a) is limited to investigating violations of this subchapter, violations of section 21 of the Federal Insurance Act (12 U.S.C. 1829b), violations of section 411 of the National Housing Act (12 U.S.C. 1730d), or violations of chapter 2 of Public Law 91-508 for the purpose solely of civil enforcement of these provisions or any regulation issued thereunder.

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A summons may be issued under paragraph (4) of subsection (a) only by, or with the approval of, the Secretary of the Treasury or a supervisory level delegate of the Secretary of the Treasury.

"(d) A summons pursuant to this section may require that books, papers, records, or other data stored or maintained at any place be produced at any designated location in any State or in any territory or other place subject to the jurisdiction of the United States not more than 500 miles distant from any place where the financial institution operates or conducts business in the United States. Persons summoned under this section shall be paid the same fees and mileage for travel in the United States that are paid witnesses in the courts of the United States. The United States shall not be liable for any other expenses incurred in connection with the production of books, papers, records, or other data pursuant to the provisions of this section.

"(e) Service of a summons issued under this section may be by registered mail or in such other manner calculated to give actual notice as the Secretary may provide by regulation.

"(f) In the case of contumacy by or refusal to obey a summons issued to any person under this section, the Secretary shall refer the matter to the Attorney General. The Attorney General may invoke the aid of any court of the United

States within the jurisdiction of which the investigation which gave rise to the summons is being or has been carried on or of which the person summoned is an inhabitant, or in which he carries on business or may be found, to compel compliance with the summons. The court may issue an order requiring the person summoned to appear before the Secretary or his delegate to produce books, papers, records and other data, to give testimony as may be necessary to explain how such material was compiled and maintained, and to pay the costs of the proceeding. Any failure to obey the order of the court may be punished by the court as a contempt thereof. All process in any such case may be served in any judicial district in which such person may be found.".

(b) Section 5319 of title 31, United States Code, is amended to read as follows:

"The Secretary is authorized to make information in a report filed under this subchapter available to a federal, state, or local agency on the agency's request. Such disclosure shall be on the terms and conditions set forth by the Secretary consistent with the purposes of this chapter. The Secretary is also authorized to make information in a report filed under this subchapter available to a federal agency when the Secretary has reason to believe such information may be relevant to a matter within the jurisdiction of the receiving agency. The Secretary is also authorized to make disclosure of infor-

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mation in a report filed under this subchapter for national security purposes. A report made available pursuant to this section and records of such reports are exempt from disclosure under section 552 of title 5.".

(c)(1) The first paragraph of subsection 5321(a) of title 31 United States Code, is amended to read as follows:

"(a)(1) A domestic financial institution, and a partner, director, officer, or employee of a domestic financial institution, willfully violating this subchapter or a regulation prescribed under this subchapter (except section 5315 of this title or a regulation prescribed under section 5315), or any person causing such a violation, is liable to the United States Government for a civil penalty of not more than—

"(A) where the violation involves a failure to file a report or a material omission or mistatement in a required report, the amount of the transaction, but not more than $1,000,000, or $25,000, whichever is greater, or

"(B) for any other violation, $10,000.

For a violation of section 5318(a)(2) of this title, or a regulation prescribed under section 5318(a)(2), a separate violation occurs for each day the violation continues and at such office, branch, or place of business at which a violation occurs or continues.".

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(2) The second paragraph of subsection 5321(a) of title 31, United States code, is amended to read as follows:

"(2) A civil penalty under paragraph (1) is reduced by an amount forfeited under subsection 5317(b).".

(3) New paragraphs (4), (5), and (6) are added at the end of subsection 5321(a) of title 31, United States Code, as follows:

"(4) A person willfully violating the provisions of section 5314 of this title or of a regulation prescribed under section 5314 is liable to the United States government for a civil penalty of not more than—

"(A) where the violation involves a transaction, the amount of the transaction or $25,000 whichever is greater, or

"(B) where the violation involves the failure to report the existence of an account or any required identifying data pertaining to the account, the entire amount deposited into the account during the reporting year or $250,000, whichever is greater.

"(5) Any person or financial institution negligently violating any provision of this subchapter or a regulation prescribed under this subchapter is liable to the United States for a civil penalty of not more than $10,000.

"(6) A civil penalty assessed pursuant to this section is in addition to any criminal penalty under section 5322 of this title based on the same transaction.".

(d) Subsection 5321(b) of title 31 is amended to read as follows:

"(b) The Secretary may bring a civil action to recover an unpaid penalty under subsection (a) within six years from the date of the transaction on which the penalty is based.".

(e) Subsection 5321(c) of title 31 is amended to read as follows:

"(c) The Secretary of the Treasury may remit any part of a forfeiture under subsection 5317(b) of this title or may mitigate any civil penalty under subsection (a) of this section.".

(f) Subparagraph (3)(B) of subsection 5312(a) of title 31, United States Code, is amended by striking the period at the end thereof and inserting in lieu thereof: "whether or not in bearer form.".

(g) Subsection 5322(b) of title 31, United States Code, is amended by striking out the words "pattern of illegal activity involving transactions of more than $100,000" and inserting in lieu thereof "pattern of any illegal activity involving more than $100,000", and by striking out the figure "5" and by replacing in lieu thereof the figure "10".

(h) Paragraph (5) of subsection 5312(a) of title 31, United States Code, is amended to read as follows:

"(5) 'United States' means the States of the United States, the District of Columbia, and, when the Secretary prescribes by regulation, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, the Northern Mariana Islands, American Samoa, the Trust Territory of the Pacific Islands, any other territory or possession of the United States, or a military or diplomatic establishment.".

SEC. 6. (a) Subsection (b) of section 1952 of title 18, United States Code, is amended by deleting the word "or" before the figure "(2)", and by deleting the period at the end thereof and replacing it with the following: ", or (3) any act which is indictable under subchapter II of chapter 53 of title 31, United States Code, or under section 1956 of this title.".

(b) Subsection 1961(l) of title 18, United States Code, is amended by inserting the phrase "section 1956 (relating to the laundering of monetary instruments)," after the phrase "section 1955 (relating to the prohibition of illegal gambling businesses),".

(c) Subsection 2516(l) of title 18, United States Code, is amended in paragraph (c) by adding the phrase "section 1956 (laundering of monetary instruments)," after the phrase "section 1955 (prohibition of business enterprises of gambling),".

Sec. 7. Section 2 of title 18, United States Code, is amended by adding the following subsection:

"(c) Whoever knowingly facilitates the commission by another person of an offense against the United States by providing assistance that in fact is substantial is punishable as a principal.".

Sec. 8. (a) Chapter 113 of title 18, United States Code, is amended by adding at the end thereof the following new section:

"§ 2322. Receiving the proceeds of a crime

"Whoever receives, possesses, conceals, or disposes of, or attempts to receive, possess, conceal or dispose of, any money or other property which has been obtained in connection with a violation of any law of the United States for which the punishment may extend to imprisonment for more than one year; or brings or transfers into the United States any money or other property which has been obtained in connection with a violation of any law of a foreign country concerning the manufacture, distribution, or other form of trafficking in any substance listed in the current schedules of controlled substances established pursuant to section 202 of the Controlled Substances Act (21 U.S.C. 812) for which the punishment under the law of the foreign country may extend to imprisonment for a period of more than one year, knowing or believing the same to be money or property which has been obtained in violation of law, shall be imprisoned for not more than ten years, or fined not more than $250,000 or both.".

(b) The table of sections at the beginning of chapter 113 of title 18 is amended by adding at the end thereof the following new item:

"2322. Receiving the proceeds of a crime".

SEC. 9. (a) Title 18 of the United States Code is amended by adding a new Chapter 120 as follows:

"CHAPTER 120—Forfeiture

"Sec.
"2600. Civil Forfeiture.
"2601. Criminal Forfeiture.

"§ 2600. Civil forfeiture

"(a) Any funds or monetary instruments involved in a violation of section 1956, and any money or other property involved in a violation of section 2322 in connection with a violation of any law of the United States or of a foreign country concerning controlled substances, and any property, real or personal, which represents the proceeds of or which is traceable to such funds, monetary instruments or other property shall be subject to forfeiture to the United States.

"(b) Any property subject to forfeiture to the United States under this section may be seized by the Attorney General, and with respect to funds or monetary instruments involved in a violation of section 1956 by the Secretary of the Treasury, upon process issued pursuant to the Supplemental

Rules for certain Admiralty and Maritime Claims by any district court of the United States having jurisdiction over the property, except that seizure without such process may be made when—

"(1) the seizure is pursuant to a lawful arrest or search; or

"(2) the Attorney General or the Secretary of the Treasury, as the case may be, has probable cause to believe that the property is subject to forfeiture under this section, in which event proceedings under subsection (d) of this section shall be instituted promptly.

"(c) Property taken or detained under this section shall not be repleviable, but shall be deemed to be in the custody of the Attorney General or the Secretary of the Treasury, as the case may be, subject only to the orders and decrees of the court or the official having jurisdiction thereof. Whenever property is seized under this subsection, the Attorney General or the Secretary of the Treasury, as the case may be, may—

"(1) place the property under seal;

"(2) remove the property to a place designated by him; or

"(3) require that the General Services Administration take custody of the property and remove it, if

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practicable, to an appropriate location for disposition in accordance with law.

"(d) For the purposes of this section the provisions of the customs laws relating to the seizure, summary and judicial forfeiture, condemnation of property for violation of the customs laws, the disposition of such property or the proceeds from the sale thereof, the remission or mitigation of such forfeitures, and the compromise of claims (19 U.S.C. 1602 et seq.), insofar as they are applicable and not inconsistent with the provisions hereof, shall apply to seizures and forfeitures incurred, or alleged to have been incurred, under this section, except that such duties as are imposed upon the customs officer or any other person with respect to the seizure and forfeiture of property under the customs laws shall be performed with respect to seizures and forfeitures of property under this section by such officers, agents, or other persons as may be authorized or designated for that purpose by the Attorney General or the Secretary of the Treasury, as the case may be.

"(e) Notwithstanding any other provision of the law, the Attorney General or the Secretary of the Treasury, as the case may be, is authorized to retain property forfeited pursuant to this section, or to transfer such property on such terms and conditions as he may determine to—

"(1) any other Federal Agency; or

"(2) any State or local law enforcement agency which participated directly in any of the acts which led to the seizure or forfeiture of the property.

The Attorney General or the Secretary of the Treasury, as the case may be, shall ensure the equitable transfer pursuant to paragraph (2) of any forfeited property to the appropriate State or local law enforcement agency so as to reflect generally the contribution of any such agency participating directly in any of the acts which led to the seizure or forfeiture of such property. A decision by the Attorney General or the Secretary pursuant to paragraph (2) shall not be subject to review. The United States shall not be liable in any action arising out of the use of any property the custody of which was transferred pursuant to this section to any non-Federal agency. The Attorney General or the Secretary of the Treasury may order the discontinuance of any forfeiture proceedings under this section in favor of the institution of forfeiture proceedings by State or local authorities under an appropriate State or local statute. After the filing of a complaint for forfeiture under this section, the Attorney General may seek dismissal of the complaint in favor of forfeiture proceedings under State or local law. Whenever forfeiture proceedings are discontinued by the United States in favor of State or local proceedings, the United States may transfer custody and possession of the seized property to the appropriate State

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or local official immediately upon the initiation of the proper actions by such officials. Whenever forfeiture proceedings are discontinued by the United States in favor of State or local proceedings, notice shall be sent to all known interested parties advising them of the discontinuance or dismissal. The United States shall not be liable in any action arising out of the seizure, detention, and transfer of seized property to State or local officials.

"(f) All right, title, and interest in property described in subsection (a) of this section shall vest in the United States upon commission of the act giving rise to forfeiture under this section.

"(g) The filing of an indictment or information alleging a violation of law which is also related to a forfeiture proceeding under this section shall, upon motion of the United States and for good cause shown, stay the forfeiture proceeding.

"(h) In addition to the venue provided for in section 1395 of title 28 or any other provision of law, in the case of property of a defendant charged with a violation that is the basis for forfeiture of the property under this section, a proceeding for forfeiture under this section may be brought in the judicial district in which the defendant owning such property is found or in the judicial district in which the criminal prosecution is brought.

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"§ 2601. Criminal forfeiture

"(a) A person who is convicted of an offense under section 1956 or section 2322 of this title shall forfeit to the United States any money or other property involved in such an offense and any money or other property, real or personal, which represents the proceeds of or which is traceable to such money or property.

"(b) In any case in which money or property subject to forfeiture under subsection (a), as a result of any act or omission of the defendant—

"(1) cannot be located upon the exercise of due diligence;

"(2) has been transferred or sold to, or deposited with a third party;

"(3) has been placed beyond the jurisdiction of the court;

"(4) has been substantially diminished in value; or

"(5) has been commingled with other property which cannot be divided without difficulty;

the person shall forfeit to the United States any other property up to the value of any property described in this section.

"(c) The court, in imposing sentence on a person for a conviction of an offense listed in subsection (a), shall order that the person forfeit to the United States all property described in subsection (a) or (b).

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"(d) The provisions of subsections 413(c) and (e) through (o) of the Comprehensive Drug Abuse Prevention and Control Act of 1970 (21 U.S.C. 853(c) and (e)—(o)) shall apply to property subject to forfeiture under this section, to any seizure or disposition thereof, and to any administrative or judicial proceeding in relation thereto, if not inconsistent with this section.".

(b) The chapter analysis of part I of title 18, United States Code, is amended by adding at the end thereof the following:

"120. Forfeiture .... 2600".

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99th CONGRESS
1st Session

H. R. 3892

To amend title 31, United States Code, to strengthen certain currency reporting requirements, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

December 10, 1985

Mr. Wortley introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

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A BILL

To amend title 31, United States Code, to strengthen certain currency reporting requirements, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. FINANCIAL INSTITUTIONS AND MONETARY INSTRUMENTS.

Section 5312(a) of title 31, United States Code, is amended—

(1) in paragraph (2) (defining financial institutions)—

(A) by redesignating subparagraphs (T) and (U) as subparagraphs (U) and (V), respectively; and

(B) by inserting after subparagraph (S) the following new subparagraph:

"(T) any foreign subsidiary or affiliate of any entity described in this paragraph;"; and

(2) in paragraph (3) (defining monetary instruments)—

(A) by striking out "and" at the end of subparagraph (A);

(B) by striking out the period at the end of subparagraph (B) and inserting in lieu thereof "; and"; and

(C) by adding at the end thereof the following new subparagraph:

"(C) as the Secretary may prescribe by regulation, any transfer of funds.".

SEC. 2. RESTRICTIONS ON EXEMPTIONS.

Section 5318(3) of title 31, United States Code, is amended by inserting after "prescribed under this subchapter" the following: ", except that the Secretary shall review each exemption not less than once during each calendar year and in any case in which there is a change in management or control of a financial institution, the Secretary shall review any exemption involved not later than 30 days after the date on which such change in management or control occurs".

SEC. 3. CHANGE IN BANK CONTROL ACT AND CHANGE IN SAVINGS AND LOAN CONTROL ACT AMENDMENTS.

(a) The second sentence of section 7(j)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1817(j)(1)) is amended—

(1) by striking out "or that" and inserting in lieu thereof ", that"; and

(2) by adding before the period at the end thereof the following: ", or that additional time is needed to assure that all persons involved will comply with subchapter II of title 31, United States Code (relating to records and reports on monetary instruments transactions)".

(b) The second sentence of section 407(q)(1) of the National Housing Act (12 U.S.C. 1730(q)(1)) is amended—

(1) by striking out "or that" and inserting in lieu thereof ", that"; and

(2) by adding before the period at the end thereof the following: ", or that additional time is needed to assure that all persons involved will comply with subchapter II of title 31, United States Code (relating to records and reports on monetary instruments transactions)".

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SEC. 4. PROCEEDS OF ILLEGAL ACTS AVAILABLE TO COMBAT MONEY LAUNDERING.

Amounts in the general fund of the Treasury which are attributable to the proceeds of—

(1) monetary instruments (as defined by section 5312(a)(3) of title 31, United States Code), and

(2) deposits or accounts in any depository institution (as defined by subparagraph (A) of section 19(b)(1) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A))),

which were declared forfeited to the United States under any law of the United States authorizing the forfeiture and seizure of the proceeds from any unlawful act shall be available, as provided by appropriation Acts, to the Secretary of the Treasury (and such other head of a law enforcement agency of the United States as the Congress may provide) for the purpose of enforcing the provisions of subchapter II of title 31, United States Code (relating to records and reports on monetary instruments transactions).

99TH CONGRESS
2D SESSION

H. R. 4280

To amend title 31, United States Code, to establish new recordkeeping and reporting requirements in order to combat money laundering, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 28, 1986

Mr. TORRES (for himself and Mr. ST GERMAIN) introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

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A BILL

To amend title 31, United States Code, to establish new recordkeeping and reporting requirements in order to combat money laundering, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Money Laundering Prevention Act of 1986".

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SEC. 2. MONETARY TRANSACTION RECORDKEEPING AND REPORTING AMENDMENTS.

(a) Report Required For Domestic Coin and Currency Transactions of $10,000 or More.—Subsection (a) of section 5313 of title 31, United States Code (relating to reports on domestic coins and currency transactions) is amended by striking out "in an amount or denomination, or amount and denomination, or under circumstances the Secretary prescribes by regulation" and inserting in lieu thereof "in amounts or denominations of $10,000 or more (or under such other circumstances as the Secretary may prescribe in regulations)".

(b) Recordkeeping Required For Domestic Coin and Currency Transactions of $3,000 or More.—Subchapter II of chapter 53 of title 31, United States Code (relating to records and reports on monetary instruments transactions) is amended by adding at the end thereof the following new section:

"§ 5323. Records on certain domestic coin and currency transactions

"(a) Records Required.—

"(1) In general.—When a domestic financial institution is involved in a transaction for the payment, receipt, or transfer of United States coins or currency (or such other monetary instruments as the Secretary of the Treasury may by regulations prescribe) in amounts or denominations of $3,000 or more, such institution (and such other person participating in such transaction as such Secretary may prescribe) shall obtain the information described in paragraph (2) with respect to such transaction and shall maintain a record of such information.

"(2) Information required to be obtained for record.—The information referred to in paragraph (1) with respect to any transaction described in such paragraph is the information described in the following subparagraphs (to the extent applicable):

"(A) The identity and address of each person participating in such transaction.

"(B) The legal capacity in which any such person is acting with respect to such transaction.

"(C) The identity of any real party in interest who is not directly participating in such transaction.

"(D) A description of the transaction.

"(b) Retention of Records for 5 Years.—Any domestic financial institution (or other person) which is required, pursuant to subsection (a)(1), to maintain a record of a transaction described in such subsection, shall retain such record for the 5-year period beginning on the date such transaction is completed.

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"(c) CONFIDENTIALITY OF RECORDS; AVAILABILITY FOR LAW ENFORCEMENT, ETC., PURPOSES.—

"(1) RIGHT TO FINANCIAL PRIVACY ACT APPLIES.—Any record of a transaction which is required to be maintained pursuant to subsection (a)(1) shall be treated as a financial record of each person identified in such report for purposes of the Right to Financial Privacy Act of 1978.

"(2) NOTICE TO PARTICIPANT IN TRANSACTION NOT REQUIRED UNDER CERTAIN CIRCUMSTANCES.—If any exception described in section 1113 of the Right to Financial Privacy Act of 1978 applies with respect to any disclosure of any record described in paragraph (1), no provision of such Act which would otherwise require that notice of such disclosure be provided to any person identified in such record shall apply with respect to such disclosure.".

(c) IDENTIFICATION OF PARTIES TO CERTAIN TRANSACTIONS REQUIRED.—Subchapter II of chapter 53 of title 31, United States Code (as amended by subsection (b)) is amended by adding at the end thereof the following new section:

"§ 5324. Identification of parties to certain domestic coin and currency transactions

"(a) In General.—Each person participating in a transaction with respect to which a report is required to be filed pursuant to section 5313 or a record is required to be maintained pursuant to section 5323 shall provide the domestic financial institution or other person required to file such report or maintain such record with complete and accurate information with regard to—

"(1) the identity and address of such person;

"(2) the interest of such person in such transaction; and

"(3) the identity of any other person for whom such person is acting in connection with such transaction, if applicable.

"(b) Responsibility of Financial Institution.—Any domestic financial institution (or other person) which is required to file a report pursuant to section 5313 or maintain a record pursuant to section 5323 shall take such actions as the Secretary of the Treasury shall prescribe by regulations to ascertain the identity of each party to the transaction with respect to which such report or record is required.".

(d) Clerical Amendments.—The table of sections for chapter 53 of title 31, United States Code, is amended by inserting after the item relating to section 5322 the following new items:

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"5323. Records on certain domestic coin and currency transactions.
"5324. Identification of parties to certain domestic coin and currency transactions.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to transactions for the payment, receipt, or transfer of United States coins or currency completed after the end of the 3-month period beginning on the date of the enactment of this Act.

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99TH CONGRESS
2D SESSION
H. R. 4573

Entitled: the "Money Laundering Prevention Act of 1986".

IN THE HOUSE OF REPRESENTATIVES

APRIL 15, 1986

Mr. PICKLE (for himself and Mr. SCHULZE) introduced the following bill; which was referred jointly to the Committees on Banking, Finance and Urban Affairs and Ways and Means

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A BILL

Entitled: the "Money Laundering Prevention Act of 1986".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Bank Secrecy Act (31 U.S.C. 5311 et seq.) is amended as follows:

SECTION 1. Section 5313 of title 31 of the United States Code is amended by adding to the end of subsection (a) a sentence which reads as follows: "No person shall cause or attempt to cause a domestic financial institution to fail to file a report required by this subsection, shall cause or attempt to cause a domestic financial institution to file a report required by this subsection that contains a material omission or mis-

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statement of fact, or shall structure or assist in structuring a transaction for the purpose of evading the reporting requirements of this subsection.".

SEC. 2. Section 5317 of title 31 of the United States Code is amended by—

(1) revising the first sentence of section 5317(c) of title 31 of the United States Code to read as follows:

"(c) A monetary instrument being transported, or which has been transported, or any interest in any property, including any deposit in a financial institution, traceable to such instrument, may be seized and forfeited to the United States Government when a report on the instrument under section 5316 of this title has not been filed or contains a material omission or misstatement.".

(2) adding a new subsection (d) which reads as follows:

"(d) United States coin or currency (or other such monetary instrument as the Secretary may prescribe) or any interest in other property, including any deposit in a financial institution, traceable to such coin or currency involved in a transaction or attempted transaction in violation of section 5313(a) of this chapter may be seized and forfeited to the United States Government under the procedures of subchapter C of chapter 75 of title 26 of the United States Code whenever a person (excluding a domestic financial institution examined by a Federal bank supervisory agency or a finan-

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cial institution regulated by the Securities and Exchange Commission liable under subsection 5312(a) of this chapter) violates section 5313(a) of this chapter. No property or interest in property shall be forfeited under this subsection if it can be established that the owner is a bona fide purchaser for value who took without notice of the violation or if the violation or attempted violation of section 5313(a) was not willful.".

SEC. 3. Section 5321 of title 31 of the United States Code is amended by—

(1) adding to subsection (a) a new paragraph (4) to read as follows:

"(a)(4) The Secretary may impose a civil penalty on a person or persons (excluding a domestic financial institution examined by a Federal bank supervisory agency or a financial institution regulated by the Securities and Exchange Commission) willfully violating section 5313(a) of this chapter. A civil penalty under this paragraph may not be more than the amount of the United States coins and currency (or other monetary instruments the Secretary may prescribe) for which a report was required under section 5313(a) of this chapter. A civil penalty under this paragraph is reduced by an amount forfeited under section 5317(d) of this title.".

(2) deleting "or (2)" from subsection (b) and adding in lieu thereof ", (2) or (4)".

(3) deleting "5317(b)" in subsection (c) and adding in lieu thereof "5317(c) or (d)" and by deleting "subsection (a)(2) of".

SEC. 4. Section 7302 of title 26 of the United States Code is amended by deleting "such property" in the second sentence and inserting in lieu thereof "property under this section and under the forfeiture provisions of title 31 of the United States Code enforced or administered by the Internal Revenue Service" and by adding "or under the provisions of title 31 of the United States Code enforced or administered by the Internal Revenue Service" after "section" in the fourth sentence.

SEC. 5. Section 7321 of title 26 of the United States Code is amended by adding "or under any provision of title 31 of the United States Code enforced or administered by the Internal Revenue Service" immediately following "title".

SEC. 6. Section 7327 of title 26 of the United States Code is amended by inserting immediately following "internal revenue laws", the following: "or under provisions enforced or administered by the Internal Revenue Service under title 31 of the United States Code, to the extent not inconsistent with the provisions of title 31.".

SEC. 7. Section 7608(b) of title 26 of the United States Code is amended by adding "or any provision of title 31 of the United States Code enforced or administered by the Internal Revenue Service" immediately following "responsible" in paragraph (1) and immediately following "the internal revenue laws" in paragraph (2)(C).

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Chairman St Germain. I think what we should do is probably listen to Mr. Wylie's opening statement, go over and cast this vote, and then return and begin with our colleague, Mr. Pickle. I will recognize him at that time. So if you want to go over and vote now and then come back, we can get started.

Mr. Pickle. Thank you.

Chairman St Germain. Mr. Wylie.

Mr. Wylie. Thank you very much, Mr. Chairman.

Last year, during our investigation into the Bank of Boston's failure to comply with the reporting requirements and other provisions of the Bank Secrecy Act, it was obvious that the bank regulatory agencies had not made compliance with the act, a priority in either their training of examiners or in the examinations themselves. In addition, it was clear to many of us that many financial institutions ignored—either intentionally or unintentionally—the requirements of the act.

However, the materials provided to this subcommittee, in response to the chairman's letter, indicate that at least the regulators have taken steps to better train examiners in their responsibilities under this act. I am also pleased to see that the industry is taking responsibility in bringing the issue to the attention of chief executive officers and other personnel. The message should be that money laundering could easily occur in any financial institution and the essential safeguard is full compliance with the reporting and recordkeeping requirements of the Currency and Foreign Transaction Reporting Act. The March issue of Credit Union magazine is a fine example of the industry's efforts. The cover story is entitled "Money Laundering: Do Not Be an Illegal Clean Machine."

It appears, from the information the committee received from the regulatory agencies this week, the regulators need some additional tools in order to upgrade their efforts to ensure compliance with the act. Now that we have the attention of the industry, we may need some modifications in the law to make the most effective use of the civil money penalties to correct continuing violations due to improper procedures or unresponsive bank officials.

In addition, we need to make every effort to pursue those who have the most interest in this, the money launderers themselves. There are several proposed bills, as the chairman has mentioned, which have been introduced in the House, including H.R. 2785, the administration's bill, which the chairman and I cosponsored, which make this activity a criminal offense with appropriate criminal penalties.

I sincerely hope that after the subcommittee has concluded its investigation and hearings into the Bank Secrecy Act, we can quickly agree on the most effective and constructive changes that need to be made in the act and in related laws. And I will pledge my assistance to you, Mr. Chairman, to convene a markup and to complete early hearings.

Chairman St Germain. I am very grateful for that.

At this time, I would ask unanimous consent that we place in the record, at the conclusion of today's hearing, reports prepared by Treasury, the Office of the Comptroller of Currency, the FDIC, and the Federal Home Loan Bank Board concerning the efforts to improve enforcement of the Bank Secrecy Act, which were prepared at my request. Without objection, so ordered.

The subcommittee will be in recess for approximately 5 minutes.

[Recess.]

Chairman St Germain. The subcommittee will come to order.

At this time, having cast that important vote on approving yesterday's journal, we can at long last hear from our distinguished colleague, a senior Member of the House and an important member of the Ways and Means Committee, indeed a subcommittee chairman.

Now, with these kinds of credentials, we know that we will benefit from this testimony. We are looking forward to this. Chairman Pickle, we will put your statement in the record and you may proceed.

STATEMENT OF HON. J.J. PICKLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Pickle. Mr. Chairman, I thank you very much. It is an honor to appear before this committee to present my testimony to you, Mr. Wylie, Mr. McKinney, Mr. Barnard, and other members of the subcommittee.

The Oversight Subcommittee of the Committee on Ways and Means has investigated problems associated with money laundering. The subcommittee held a hearing last year focusing specifically on the responsibilities of the Internal Revenue Service in this area.

In addition, several members of the committee toured the IRS training facility at the Federal Law Enforcement Training Center in Glynco, GA, to learn more about the IRS enforcement in this area.

Our subcommittee's investigation resulted in two important findings. One, we found that because of loopholes in the current law, that Government has been unable to successfully prosecute the person who puts together schemes that allow illegal source cash to be laundered.

We also found that problems existed in the ability of the IRS to seize illegal source income when a criminal such as a drug dealer launders illegal source income through domestic financial institutions.

We as a nation are losing our battle against the flow of illegal drugs. Money laundering is an intricate part of the drug trafficking process. Therefore, any efforts to try to stop the drug traffic must stop the money laundering associated with it.

Also, I should point out that businesses and individuals in the United States are laundering income from both legal and illegal activities. This problem is a growing one. As a result, I am concerned about the impact of the money laundering operation in the collection of U.S. Federal income taxes.

As members of this subcommittee are aware, the enforcement of the Bank Secrecy Act reporting requirements is the responsibility of the Secretary of the Treasury, who has delegated this authority to the Internal Revenue Service. Under current law, a domestic financial institution must report cash transactions of $10,000 or more to the Internal Revenue Service.

In a typical scheme, money launderers often break up large sums of money into transactions of less than $10,000 to avoid having the financial institution report the cash.

I asked the administration to work with my committee in drafting legislation that would close loopholes in the law that have not allowed the Government to successfully convict money launderers and will give the Internal Revenue Service adequate seizure and forfeiture authority.

The bill that I introduced yesterday, H.R. 4573, represents the results of this joint effort. This bill was drafted by the administration in close consultation with my staff. It has the approval of the Treasury, and OMB has also signed off on it.

The bill closes the loopholes in the current law which allows the money launderer to escape conviction and provides the Internal Revenue with seizure and forfeiture authority when there are violations of Bank Secrecy Act reporting requirements.

The bill as drafted is under the jurisdiction of your committee, Mr. Chairman, and I know that your committee is going to evaluate this legislation and I hope it will be helpful as you improve the Bank Secrecy Act.

Before I outline my bill, I think one thing should be made clear. The administration has developed its own comprehensive approach to address the entire area of money laundering, their proposals being actively worked on in the House and Senate Judiciary Committees, and I encourage all efforts in this area. It is a broad field that they are looking into now. This bill, H.R. 4573, specifically targets the actual money launderer, often called a smurf, and all other parties involved in the money laundering scheme.

My bill, which has administration support, is designed to complement other money laundering proposals. This bill, even if it is enacted on its own, will be useful in addition to current law in combating money laundering activities.

Now let me, Mr. Chairman, take just a couple of minutes more to outline the three sections of the bill so that you have a summary of what the bill provides.

Section 1 of the bill expressly subjects persons to criminal and civil liability where they cause or attempt to cause a financial institution to fail to file a required Currency Transaction Report, commonly referred to as a CTR, or to file an incorrect CTR. This will be helpful in not only getting the smurf who does the actual transaction but also those who plan the activity.

This would allow Treasury and IRS to act before the 15 days that the financial institution has to formally file a CTR.

Also, the bill makes it an offense to structure or to assist in structuring a transaction to evade the reporting requirements. For example, this provision would prohibit the structuring of a transaction to circumvent the reporting requirements by involving two or more financial institutions.

Section 2 of my bill allows forfeiture and seizure authority to be used by the Internal Revenue Service to seize laundered cash and property directly traceable to the laundered cash. Thus, both the IRS and the Customs Service would be able to use seizure and forfeiture more effectively to get the money or the property before it disappears.

However, there are protections in my bill for the innocent third parties. If a person proves he has acted in good faith, is a bona fide purchaser of cash or goods from a money laundering scheme or could prove that his failure to file a CTR was not a willful violation, his cash or property would not be subject to seizure or forfeiture.

Section 3 of the legislation provides a new civil penalty for violation of the Bank Secrecy Act. The amount of the penalty would be the difference between the amount forfeited under section 2 and the total amount of the laundering transaction. Again, the standard of this civil penalty would be a willful violation.

In conclusion, Mr. Chairman, I believe the need for this legislation is obvious. Federal courts have taken the position that there is inadequate legislative authority to prosecute people who are actively engaged in money laundering operations. At a minimum, this loophole should be closed forever, and under this bill, it would be.

Also, for the first time, this legislation would allow the Internal Revenue Service to seize and forfeit cash and property that is involved in the violation of the Bank Secrecy Act. As members of this subcommittee may know, laundered money cannot be seized before there is difficulty in proving that there is a nexus between the money launderer and a criminal activity. In most cases, the case involves illegal drugs.

This bill represents a careful effort to strengthen IRS enforcement authority against money laundering while at the same time protecting third parties.

I am enclosing for the record, Mr. Chairman, a copy of the bill with a detailed section-by-section explanation.

Mr. Chairman, that completes my testimony. I have with me Vanessa Clark, a member of the Oversight Subcommittee staff, to assist in any questions that might be asked by your subcommittee.

[The prepared statement of Congressman Pickle can be found in the appendix.]

Chairman St Germain. Thank you, and initially I would like to commend you on the actions you have taken to resolve this problem. Certainly, we need the help and support of as many Members as possible, and it is nice to see someone like you taking a lead in this area.

Now I would like to ask you one question. Forfeiture under any circumstances is a very drastic action; but nonetheless, you do make a very valid case for forfeiture provisions in your bill. Would you tell the subcommittee what safeguards are contained in your bill so that innocent individuals would not become subject to the forfeiture provisions?

Mr. Pickle. Mr. Chairman, I stated in my legislation that one section of the bill attempted to protect these innocent third parties. More specifically——

Chairman St Germain. Yes, if we could have more detail on that.

Mr. Pickle. You raise a question about what protections are in the bill to protect innocent third parties from the forfeiture provision. Well, No. 1, the bona fide purchasers are exempt from the bill. That is a person who actually gets the property, the cash, and gets it innocently and he can so prove that. If he is a bona fide purchaser, he would be exempt.

Second, the violations which are not willful are exempt from the bill. That is if a third party accidentally came into possession of this money, which could happen, and if that could be proved, that it wasn't a willful evasion, then that transaction would be exempt.

Also, the Internal Revenue procedures would allow for immediate corrections where there is an error. The intent is that if you are a third party and you are an innocent third party, you ought to be exempt, and we are trying to make that as clear as we can in the legislation.

Chairman St Germain. I would like to now recognize another distinguished member of our subcommittee, who has conducted hearings in this area with his Subcommittee on Government Operations. Those hearings addressed the Federal response to criminal misconduct and insider abuse in the Nation's financial institutions. Additional hearings were also held on tax evasion through the Netherlands Antilles, and other tax haven countries.

So we have the benefit of the assistance of another distinguished colleague who, as I say, has had his own hearings in this area. At this point, I recognize Mr. Barnard.

Mr. Barnard. Thank you, Mr. Chairman.

Also let me express welcome to the Honorable Jake Pickle for being with us this morning and compliment Jake on what he has done in this area and also the legislation he has brought before us.

Chairman Pickle, if your bill had been into law before now and with all of the revelations of money laundering operations that we have had in the last several years, what do you think would have been the consequences of that? Have you studied that?

Mr. Pickle. Well, we have looked at it, and it is hard to speculate. We know now that the money laundering is a wholesale operation and that these evaders, launderers, move from one part of the country to another as soon as the heat moves in on them. They go from the Florida area to the west coast, and of all things, they are about to come into the Rio Grande Valley.

I think if we had the authority to actually have seizure and forfeiture, and if we could actually move in and get a conviction on the smurf or those who are planning money laundering operations. I think we could cut the money laundering in half. I also think we could cut the violations on the drug smuggling, perhaps, in half.

Now, that is conjecture on my part. I don't know that we have got any actual figures on how much this legislation if passed, we cut money laundering.

Mr. Barnard. What would have happened to some of those who have been negligent in reporting money laundering operations in some of the financial institutions of the country? What would have happened in some of those instances?

Mr. Pickle. I would venture to say, Mr. Barnard, that if those individuals, had cooperated in a money laundering scheme, they would have been subject to prosecution under the law.

Mr. Barnard. And this is one thing that your bill does, it does bring those who have been guilty from the standpoint of not reporting.

Mr. PICKLE. Yes. Either the smurf or the individual working in the institution, if they are negligent in reporting the currency transaction, would be subject to the provisions of this law. Some of our financial institutions haven't done it, and they are claiming now that they haven't filed these reports innocently and find it was a surprise that they were supposed to make these currency transactions known. But the truth of the matter is, I think, we ought to be very diligent in reporting currency transactions and use this legislation to insist on it.

Mr. BARNARD. Do you think we need to do something in your bill to strengthen the enforcement of the law? In other words, I notice in the testimony of our chairman he indicated that this responsibility had been turned over from the Treasury to the IRS, but the IRS seems to be in on it after the action, not before the action, while we have got the Bank Examination Department of the Comptroller of the Currency supposed to be in there on an active periodic examination.

Do you think there should be some change in direction as far as investigating these reports?

Mr. PICKLE. I would assume that the bills that the administration has supported in the other areas under the jurisdiction of other committees, for instance, Judiciary, would probably emphasize enforcement. I try to concentrate on the two or three areas that are mentioned here because, I think, the Internal Revenue Service should be given the information and the right to do something before they have to wait until the full 15 days, for instance, for the report to be filed.

This bill allows the Internal Revenue Service to move in and move in quickly. Now, whether you should have increased penalties, I think, would be a matter that would be more appropriately under the Judiciary Committee.

We want to give the law enforcement authority the right to go in and act immediately.

Mr. BARNARD. Your hearings, have they indicated any more importance been given to this operation by the banks, the regulators and IRS than before?

Mr. PICKLE. I don't know how much importance they put on money laundering. I do know that the areas of money laundering and the tax evasion are directly related. Also, probably a great percentage of the violations now are in the area of drug trafficking.

Unless we can give the governmental entities the authority to move and move quickly, then, I think, we are going to let the money laundering operations go untouched.

I would say that we ought to serve clear notice to the financial institutions that they should know what the law is, what amount of cash must be reported, and to whom it should be reported. If we give the authorities the right to move in and catch these people when they have proof that these people are, in fact, money launderers, the authorities can move in on money laundering operations.

Mr. BARNARD. That is the thing that concerns most of the members of our committee. The law has been in place for a number of years. It seems to be just lackadaisically overlooked. Somehow or another, we have to put more emphasis on the fact that these institutions have got to report these transactions. I guess your bill does in that regard put more teeth into the law, as far as if they don't do it, somebody in that institution, whether it is a bank or money exchange, or whatever it might be, which is another thing we have to do. We have to broaden this bill to include more than just banks and investment houses. There are others in the money exchange business that are being left out of this bill.

I think your bill is a good step forward in getting something done. I compliment you.

Mr. PICKLE. I pointed out to you that the administration recognized this is a problem. They ought to give the Internal Revenue Service forfeiture and seizure authority. They also ought to have the right to say it is illegal to cause a violation of the Bank Secrecy Act. Having recognized that, the administration, through the Treasury and the Office of OMB, has said the Congress ought to pass this legislation.

I think it is a base. I hope this committee will consider it as a part of your bank secrecy legislation as you move forward.

Mr. BARNARD. Thank you.

Chairman ST GERMAIN. Mr. Wylie.

Mr. WYLIE. Thank you, Mr. Chairman. I, too, would welcome you, Jake, and commend you for your concern and your conscientious hard work in an area which is a serious problem to us.

You say that you have worked with the administration and they support your legislation. Chairman St Germain and I also introduced a bill at the request of the administration.

Do you know up front, and I wouldn't expect you to, how the two bills compare? Are there similarities in the approach taken in your bill and our bill?

Mr. PICKLE. I am not sure. I know there is legislation pending in other committees, here and in the Judiciary and Government Operations.

Mr. WYLIE. We will have staff take a look at that.

Mr. PICKLE. This would be a part of the composite bill that I assume you primarily will advance.

Mr. WYLIE. Yes. I think the point and place where I am coming from is that we are all concerned about this money laundering problem. We thank you very much for your testimony this morning. You are a member of the Ways and Means Committee. You say this problem is a growing one. As a result, I am concerned about the impact of money laundering operations on the collection of U.S. Federal income taxes. We just passed a big day in our year as far as income taxes are concerned, yesterday. I am glad to see you do pay attention to such things. Do you have any notion as to how much of an impact in the loss of Federal tax revenues this might have?

Mr. PICKLE. Let me ask Vanessa Clark to comment on that. Before I do, with respect to the tax laws, we quite often cannot move in on these money launderers unless we can show a direct connection with a tax case, such as a criminal violation of the Tax Code.

Pending the proof of that, a lot of these people get their money laundered and move on. We don't have time to act. This legislation would give the IRS the authority to seize and forfeit laundered cash immediately, without having to wait, or to connect it to or requiring a nexus with a violation of the Tax Code.

I think our legislation would help speed up the Government's ability to act. Ms. Clark, do you have any comment to make?

Ms. CLARK. Yes. I have several comments to make. First of all, on the seizure and forfeiture authority, and I'm sure this committee is aware that the——

Chairman ST GERMAIN. Excuse me. Ms. Clark, if you would pull your microphone closer. We have lousy microphones; but we can't do anything about it because of Gramm-Rudman. You have to cuddle up to it. [Laughter.]

Ms. CLARK. There are several points I would like to make. First of all, I would like to talk about why the IRS should have seizure and forfeiture authority. The CTR's, as your committee is aware, are reported to the IRS. They are the agency that has the information on hand from the banks. Therefore, it is logical and appropriate to have the IRS have the authority to take some action, where they are on notice that a money laundering operation is going on and money is not being reported through the CTR process.

As it stands now, seizure and forfeiture authority under the IRS is somewhat restricted and there has to be that nexus to the evasion of taxes or unreported taxes. That is, seizures have to be related to the fact that you haven't reported taxes, you haven't paid taxes or some other Tax Code violations.

This bill would expand that seizure and forfeiture authority given to the IRS. As the authority exists now, the IRS does not have that authority to seize laundered cash. The IRS's ability to seize laundered cash without having a nexus to a Tax Code violation would be a major difference between the current authority of the IRS and the expanded authority under this bill.

Mr. WYLIE. Do you have any notion as to how much money we might be losing? Did IRS give you any estimate on that? You can supply that for the record.

Ms. CLARK. We have had some estimates given to us. I can't vouch to the sources at this particular point. We can submit that for the record. There have been estimates of maybe $90 billion altogether due to tax avoidance or evasion and maybe approximately half of that could be attributed to money laundering alone.

Mr. WYLIE. Did you say $90 billion?

Ms. CLARK. $90 billion. We are talking about maybe $50 billion of this amount being attributable to money laundering operations.

Mr. WYLIE. Holy smoke. Thank you very much. Thank you, Mr. Chairman.

Chairman ST GERMAIN. Mr. Annunzio.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

I am delighted to associate myself with your remarks and the remarks of the other members of the committee in welcoming a dear and old friend, Jake Pickle, to the hearing this morning.

I want to publicly acknowledge that at the time you became chairman of the Subcommittee on Social Security, everybody was so worried and concerned that the Social Security system would go under as it was operating in the red. Under your chairmanship of that subcommittee, you managed legislation whereby the Social Security fund is now solvent. It is in the black, it is not in the red.

The credit goes to you for being such a watchdog of the system. In fact, it has a surplus today, I understand. Everybody is trying to get their hands on it.

I am one of those who have cosponsored a bill to take Social Security out of the budget process, just leave it alone. It is in the black, we want to keep it there. I wanted to publicly acknowledge your great contribution to the people of America.

Mr. **Pickle**. You are very kind, Mr. Annunzio. I appreciate it.

Mr. **Annunzio**. As we all know, Mr. Pickle, money laundering is really big business. We have had hearings in this committee, our chairman has been very diligent on following money laundering operations. We have exposed large institutions throughout the United States; I am talking about bankers.

One of the things that bothered me was the fact that the officers of these large banks or the banks themselves only paid a fine. No one went to jail, that I know of. Maybe the dope peddler went to jail. As far as the banking executives, I don't know of any that went to jail. If any have gone to jail, it has slipped me.

You are absolutely correct. We have to strengthen the law so that people can be punished, whether they be criminals or bankers. If we are going to stop the drug traffic in America we have to stop the money laundering. We have to stop the money at the source so they will not be able to replenish their stock and buy new drugs in order to continue in business. I think if we stop the laundering of money, we have a very good opportunity of stopping drug trafficking in the United States. I am delighted you are taking the leadership role on this money laundering, as well as our committee and our chairman, who is also taking a leadership role.

I think it was back in 1970 when we passed the Bank Secrecy Act. All these years have gone by. We want to strengthen that law. I think your legislation will help strengthen that law. It will curb money laundering and by curbing money laundering, we can curb drug trafficking.

I commend you for the great effort you are making.

Mr. **Pickle**. Mr. Annunzio, we saw movies and received testimony from a lot of the operators who are trying to put a stop to this. We were shown that a lot of the financial institutions really didn't make much of an effort to know where the money came from. One of the banks in the Northeast actually received money that was hauled in in gunny sacks. The bank had to just count out the cash. I don't know if there were any loose coins in there. It was just that open and brazen.

You do not have to tell any of us that the bank knew they were not filling out the forms. That money came from somewhere and it wasn't legal money.

Some of the institutions have really become that lax. When that happens, we ought to have a law, not only for enforcement, but to do something to the individuals in that institution. They know better. I think this legislation together with the possible penalties against the institution will save the Government the right to put the smurfs in jail and to seize and forfeit the laundered cash. It will also reduce the violations of the bank secrecy laws considerably.

Chairman **St Germain**. Mr. Torres.

Mr. **Torres**. Thank you, Mr. Chairman, for allowing me to sit on your subcommittee today. As you know, this is an issue in which I am very interested. Drug money has become an official form of American foreign aid to Latin America. We know that Latin America is beset by horrendous inflation and foreign debt, that many Latin American countries need dollars to desperately finance their programs and laundering has become a paradise in Latin America as well.

It is estimated that $2 billion is laundered through some of the offshore banks in Panama, Colombia, and Peru.

I am appalled this morning to learn that the U.S. Government loses about $50 billion a year through money laundering schemes? Is that correct?

Mr. **Pickle**. That is approximately correct, Mr. Torres.

Mr. **Torres**. I dare say that compounding both these economic crimes and social crimes, that there is another issue that obviously concerns me, and that is that money laundering is being used along with drug sales to perhaps finance gun running in this hemisphere. We have heard that of late, vis-a-vis the situation in Nicaragua and Honduras.

What light can you shed on that, Mr. Pickle? Is there any evidence that money laundering is being used as a vehicle to purchase arms for the Contras in Latin America or Central America?

Mr. **Pickle**. I don't think I can comment on that, Mr. Torres. I do not know. I am sure money laundering is so flagrant that it is almost a means of financing any kind of operation. I would not be surprised if that was not the case, but I don't know that.

Mr. **Torres**. Thank you very much, and thank you, Mr. Chairman, for your time.

Chairman **St Germain**. Thank you, Mr. Torres. Mr. McKinney.

Mr. **McKinney**. Thank you, Mr. Chairman. It is a delight to welcome my neighbor here. He is a busy man so I will be brief.

I would love to hear your opinion as to what the definition of a financial institution is. I understand later on we are going to hear about a case where an individual was named a financial institution. It seems to me that this has become so bad in the stock market, the bond market, the futures market, and the commodity market, that we need to get some turf around here and really stretch out a little bit.

I had a real estate broker tell me that the State of Florida has one of the biggest go-go real estate markets in the country. In fact, in the southern tip of Florida it was possible to buy a house with a foreign check and then turn around and put the house on the market. You are bound to make money, even on the house. Then you have a legitimate 500,000 dollars' worth of cash or whatever you sell the place for.

Something has to be done. These guys are floating checks all over the place. Southern Florida is a bottomless pit of laundered money and drug money. The drug business will stop when they can't get anybody to do anything with the money. That is the only reason people are in it. That is the only reason people are getting or buying million dollar boats to carry the stuff into Florida.

It seems to me we have to stretch our basis of who gets clipped here. I was just wondering what you thought about it over at Ways and Means.

Mr. PICKLE. When we looked at some of their operations, we were shocked that it was so open and so flagrant in almost every form. The operator would hire young college students in a lot of instances and coach them a little bit and send them down to the banks. They would pick out the different banks. They had cased one town pretty accurately. The money launderers are so open about it that it almost got to be a way of doing things. I think the institutions looked the other way.

As far as the definition is concerned, my legislation does not try to provide a new definition of what is a financial institution. I think that is a problem. I am advised that title 31 has a broad definition of financial institutions. I would assume that would be broad enough to reach almost anyone who holds himself out as a financial institution.

It would not necessarily be limited to just a bank or a savings and loan, but anybody holding out to be a financial institution. I think the tightest definition we could get would be helpful.

Mr. MCKINNEY. It was interesting, Jake. When I first came to this place 16 years ago, the definition of a financial institution was very clear. It is a mess now. It is socks, shoes, underwear and everything else. It bothers me. Every single one of these aspects from real estate through stocks is being used to launder money. These louses are not only killing our kids but they are laundering money outside the tax system. I think it is time that we get justifiably mad. Who is the enemy? Nicaragua? I believe the enemy is often right in our own country. Enough said.

I appreciate your testimony. I appreciate your bill. I will cosponsor the same.

Mr. PICKLE. Thank you.

Chairman ST GERMAIN. Mr. Wortley.

Mr. WORTLEY. Thank you, Mr. Chairman.

Welcome to the Banking Committee, Mr. Pickle. We certainly appreciate your taking an interest in this very critical issue. After all, you are one of the most distinguished Members of this body and a master crafter of legislation. To find you focusing in on it is very gratifying.

Do you in your legislation make money laundering per se a crime or do you not address that aspect of it? Money laundering is a crime, it is wrong, but nobody really says that within itself it is a crime.

Mr. PICKLE. I am advised that is not the case. It would not be specifically a crime in itself.

Mr. WORTLEY. You focus in a lot on the smurfing aspects of it. Do you address anywhere in your bill the collaboration or provide for punishment of employees of banks, who knowingly participate in money laundering conspiracies?

Mr. PICKLE. Mr. Wortley, with respect to an institution, any employee within the bank who assists in that failure to file one of these CTR's is guilty of the violation and would be subject to prosecution.

Mr. WORTLEY. The way things have been happening in the marketplace is that the banks themselves have been punished, usually with a very stiff fine. Thus far, I haven't seen any employees of banks or bank officers hauled into court for their complicity in money laundering.

I was just wondering if we need to strengthen the laws in such a way that we get to individuals. It isn't just an institution that makes it happen, but some individuals within that institution, whether it is bank officers who approve organizations on the exempt list, or a teller who takes a little money under the table, for splitting deposits and so on. We never seem to convict any individuals. It is always the institution that takes the rap but never an individual.

Do you get into addressing that, Jake?

Mr. PICKLE. No, I do not, except to say that any individual who participates or causes for these reports not to be filed is guilty of the violation and ought to be prosecuted. I do not try to detail the extent of the penalty. If we don't make this thing broad enough to include both the institution and the individuals such as the smurf or the man who plans the money laundering scheme, then this operation is going to go on and on and get bigger and bigger.

Today, the percent is staggering and it is beyond belief that we have so much money that is underground. At best, it is difficult to catch the money. These money launderers are outside the law and they are trying to avoid it to begin with.

If we don't give our governmental agencies the vehicle, then I don't think we are going to put a stop to it. If we say drug trafficking is one of the worse problems in America today, and it is, then we know that drug traffickers have to have money laundered or they will not have drug trafficking. They go together, inseparably.

As far as I am concerned, the stiffer the penalty the better and I try to give the agency over which our committee had primary jurisdiction, the Internal Revenue Service, the right of seizure and forfeiture. To further penalize the money launderer, we also give the IRS the right to move in quickly. I think this will help a lot.

There is a broader bill pending before this committee and several other committees. This legislation ought to fit into other legislation in the appropriate place. This legislation goes to the heart of the matter. I am pleased that the administration has taken the initiative and said, we need to do something and we have asked you to introduce this bill, and let's get with it. I am encouraged.

Mr. WORTLEY. There is no doubt about that, that narcotic trafficking is undermining the integrity of society. I want to thank you very much for joining in the battle with the rest of us. Thank you, Mr. Pickle.

Chairman ST GERMAIN. Mr. Bartlett.

Mr. BARTLETT. Thank you, Mr. Chairman. I have no questions other than to commend my colleague from Texas for his diligence in this area. He has displayed good work on some legislation that needs to be adopted. I am pleased that he is before this committee making this presentation. I commend him for his work.

Mr. PICKLE. Thank you, Mr. Bartlett.

Chairman ST GERMAIN. Thank you very much.

Mr. PICKLE. Thank you, Mr. Chairman. I thank the committee.

Chairman **St Germain**. At this time, the subcommittee would ask Herbert Friedberg to come to the witness table.

He will be accompanied by Mr. Ted Bandstra, Assistant U.S. Attorney, Southern District of Florida, the Department of Justice.

Mr. Friedberg, we welcome your testimony before the subcommittee and we want you to know that we appreciate your willingness to appear. Your experience as a money launderer or smurfer, as that activity is sometimes called and has just been referred to by the previous witness, will be, I am sure, most beneficial to the members of the subcommittee in our efforts to draft legislation to combat this illegal activity.

Mr. Bandstra, let me take this opportunity to thank you and the Department of Justice for your full and complete cooperation in working with committee staff to secure Mr. Friedberg as a witness before this subcommittee.

Now, I will ask my Members to listen to what I have to say at this point—Stu, David. I just welcomed Mr. Bandstra as well, and it is my understanding Mr. Friedberg may be a key witness again in an upcoming trial. We would not want to cause the Department any litigation problems in that case, so we have asked Mr. Bandstra to feel free to let us know if we are leading Mr. Friedberg into any matters that should remain confidential.

In addition, it is also my understanding that you are making yourself available to answer questions of the committee members that may be of assistance to us so that we better understand Mr. Friedberg's operation and other related matters. For that we are also grateful.

Mr. Friedberg, we will put your entire written statement in the record, without objection. We appreciate having received it ahead of time. I am informed by my very efficient staff that, having placed the testimony in the record, that you are prepared to elaborate a bit with some examples, and certainly that would be of assistance to us. So just feel free. We are here to listen.

STATEMENT OF HERB FRIEDBERG, FORMER MONEY LAUNDERER, ACCOMPANIED BY ASSISTANT U.S. ATTORNEY TED E. BANDSTRA, SOUTHERN DISTRICT OF FLORIDA, DEPARTMENT OF JUSTICE

Mr. **Friedberg**. Thank you, Mr. Chairman.

Rather than read from my statement, I would like to give you the history of how I became involved in money laundering. I was a property manager for a luxury condominium in the Miami area, and in 1983, due to an injury, I had to leave that job. While working in this condominium, I had the opportunity to meet a Colombian national, Mr. Jack Behar, who was a resident of the building and had an import/export business in Miami.

I was out of work for approximately 4 months. Mr. Behar contacted me and asked me how I was earning a living not working, and I told him I wasn't, I was simply on compensation. He asked if I would care to help him out on occasion; since he was so busy with his own business, could I take some cash to banks for him at various times and pick up some cashiers checks or money orders, for which he would pay me.

Starting in January 1984, Mr. Behar would deliver sums of money to me, $15,000, $20,000, $25,000. I would be paid anywhere from $50 to $100 for converting this into cashiers checks and money orders. Specific instructions were to never make out a check for more than $9,000, always make out a check in a Latin name, a Latin name being Gonzales, Rodrigues, et cetera, and the remitter, put down any name there I chose, and we picked a property management company and we used that.

This continued from January through April 1984, and Mr. Behar made a trip to Colombia on business, came back and asked me if I would like to make a trip to California with one of his associates who worked with me at the time, with Mr. Behar, actually. Supposedly, there was $400,000 waiting in California to be picked up and either brought back to Miami or laundered in the California area. We never used the term "laundering." At that point I had no idea we were doing anything illegal, other than the fact that Mr. Behar was a businessman, and I did not know making out cashiers checks was illegal.

We went to California. All we had was a beeper number, and we arrived in California, in Los Angeles, dialed a beeper number, received a return call at our hotel, and set up an appointment with a gentleman, Hecho, went to a house in Palos Verde when Hecho called us back and gave us an address, and sitting on a table we found $200,000, not the $400,000, and this $200,000 was turned over to us without any identification other than the telephone call and the fact that here we are and here is the money.

We started working Wilshire Boulevard on a Monday morning with $200,000 in cash, and by Tuesday at 11, we had converted the $200,000 into cashiers checks. We had no California identification. We were two Florida residents. Not one bank asked us to identify ourselves, and in each institution we made out checks in the amount of $9,000, converted the entire $200,000 in 1½ days never leaving Wilshire Boulevard.

When I arrived back in Miami—did you want to say something, sir?

Chairman St Germain. Oh, no, no. Mr. Torres sees how popular—see, he is from California. They must have a lot of banks on Wilshire Boulevard.

Mr. Friedberg. One on every corner, sir.

When we arrived back in Miami, I found an article in the Miami Herald describing money laundering, and at that time I realized I was involved in money laundering. I immediately contacted the Federal Bureau of Investigation and they turned me over to the Internal Revenue Service, Operation Greenback, in Miami.

I met with two agents and explained exactly what I had been doing for the past 5 months, and at that point I was asked to go to work for the U.S. Government as an informant. From June 1984 through February 1985, I worked for the U.S. Government, laundering money for a number of money launderers in the Miami area, turning over the back copies of the cashiers checks or money orders and allowing the Government to build a case up against these people.

I don't know if you have any questions now. I think you pretty much have an idea of what my activities were.

Chairman **St Germain**. I certainly do have some questions. I just want to make sure you have had an opportunity to tell your entire story.

Mr. **Friedberg**. I think that's about it.

Chairman **St Germain**. Fine.

[The prepared statement of Mr. Friedberg can be found in the appendix.]

Chairman **St Germain**. Mr. Friedberg, you say that it wasn't until you returned from California, having introduced yourself to many banks on Wilshire Boulevard, and were in Miami that you saw the article in the paper about money laundering. Tell me. When you were asked by your friend, who lived in the apartment complex that you worked in, to go to work for him and convert cash into cashiers checks using any old name that you wanted and using phony names as the remitters, and the fact that he was paying you to go from one bank to another and cautioned you to stay under $9,000, that didn't ring a bell with you? Didn't you say to him, well, how come we are using all these phony Latin names? Didn't that ever occur to you?

Mr. **Friedberg**. Absolutely. I questioned him on a number of occasions, and Mr. Behar is a very eloquent individual. Mr. Behar had a legitimate import/export business. Mr. Behar said that he was in the money exchange business in Colombia, constantly on the phone with Colombia, 10 to 12 times a day, always knew the peso in relation to the dollar, et cetera, could always tell you, well, we are buying dollars and selling dollars and it is much easier if there is a Latin name because we do send the checks down to Colombia, and if it is in the name of a Latin, we don't have any problem, but when it's in American names, they get a little suspicious.

Chairman **St Germain**. Let's look at the name of the remitter. He said to use different names for remitters, phony names.

Mr. **Friedberg**. It didn't make any difference at that point. It came from a management company. His statements really were that the problem was not here in the United States but in Colombia, and he was defrauding the Colombian authority, which is what he was saying, that they were bringing the money into Colombia not to have to pay taxes on it or to avoid problems not in the United States but in Colombia.

Chairman **St Germain**. Were you collecting workman's compensation?

Mr. **Friedberg**. No, I stopped in January, sir, when I started to work for Mr. Behar. My compensation ended in January.

Chairman **St Germain**. Because you were no longer considered disabled or because you——

Mr. **Friedberg**. I was no longer disabled. They stopped my payments in December.

Chairman **St Germain**. Oh. And you didn't contest that?

Chairman **Friedberg**. No, sir.

Chairman **St Germain**. You are unusual. I used to do workman's compensation work, and very few went off voluntarily.

You said that you were not asked for any identification whatsoever when you were in California on Wilshire Boulevard?

Mr. **Friedberg**. That is correct.

Chairman **St Germain**. While operating, did you restrict yourself to the greater Miami area for your purchase of cashiers checks?

Mr. **Friedberg**. I did. I had approximately 8 to 12 bank accounts under my own name. That's another thing. Not realizing I was committing any crime, I opened bank accounts in my own name. Every time I went into a bank, it was in the name of Herbert Friedberg. I didn't go in there looking to——

Chairman **St Germain**. So you identified yourself as Herbert Friedberg?

Mr. **Friedberg**. That's correct.

Chairman **St Germain**. And then you would purchase a cashiers check?

Mr. **Friedberg**. That's correct.

Chairman **St Germain**. You would then put the phony names on, for both the remitter and the payee?

Mr. **Friedberg**. Yes, sir.

Chairman **St Germain**. Now, you worked with eight or nine different banks?

Mr. **Friedberg**. Almost 12 banks.

Chairman **St Germain**. Twelve banks; is that it?

Mr. **Friedberg**. Yes, sir.

Chairman **St Germain**. Which means you were going in on a regular basis?

Mr. **Friedberg**. Continuously.

Chairman **St Germain**. Were you using the same tellers, pretty much the same tellers in those banks?

Mr. **Friedberg**. They got to know me on a first-name basis.

Chairman **St Germain**. And they never questioned you and said, Mr. Friedberg, what kind of business are you in that you have so much cash?

Mr. **Friedberg**. It never was questioned, sir.

Chairman **St Germain**. Would you say that one teller in a period of 2 weeks might have seen you come in five or six times with $5,000?

Mr. **Friedberg**. Not quite that much frequency. I would say at least two to three times.

If I might voice an opinion, sir, again having listened to Mr. Pickle and the members of the committee and the questioning, I realize the direction you were going.

The banks are obligated to report a transaction over $10,000 and the tellers are told that any transaction over $10,000 they should be aware of. When you walk in with $9,000, even though they might suspect that you are a money launderer or where the money has come from, their obligation is not to report it.

Because they are not obligated, they feel they are within their rights not to say anything.

Chairman **St Germain**. You see what you are referring to is the fact that they were looking the other way on aggregation.

Mr. **Friedberg**. Correct, sir.

Chairman **St Germain**. Did they ever say to you, "Mr. Friedberg, where is all this cash coming from?"

Mr. **Friedberg**. No, sir.

Chairman **St Germain**. They never asked you what kind of business you were in?

Mr. **Friedberg**. It was not within their realm to ask that question.

Chairman **St Germain**. Wait a second. That is your opinion.

Mr. **Friedberg**. No, sir. They felt that it was not within their realm.

Chairman **St Germain**. You say that they felt it wasn't within their realm. Let's face it. If you were a bank teller and this fellow, Mr. Bandstra, came in to see you twice a week or once every 2 weeks with $9,000 on a regular basis, wouldn't you say to yourself, "I wonder where that guy is getting all this cash?"

Mr. **Friedberg**. I certainly would.

Chairman **St Germain**. You would?

Mr. **Friedberg**. Absolutely.

Chairman **St Germain**. That is our point.

Mr. **Friedberg**. Yes, sir. I would be very curious. Again, your question——

Chairman **St Germain**. Did you not at some point in time feel a little queasy that they might ask you, some of these tellers that you would see more than one time?

Mr. **Friedberg**. Yes, sir——

Chairman **St Germain**. But you figured as long as they didn't, you could keep going; right?

Mr. **Friedberg**. I am losing the question.

Chairman **St Germain**. In other words, if you felt that perhaps they might put the finger on you and start asking you questions, where is this cash coming from, how come, A, B, C, D, that then you would have said to yourself, "I better not hit that bank again for a month or so?" Did that ever happen?

Mr. **Friedberg**. No, sir. I just again——

Chairman **St Germain**. So you felt perfectly free to go back into the bank?

Mr. **Friedberg**. The problem again, sir, never arose.

Chairman **St Germain**. It never occurred to you that there would be a problem?

Mr. **Friedberg**. No, sir.

Chairman **St Germain**. They were very friendly and cordial and happy to get the fee you were paying them for the cashier's check?

Mr. **Friedberg**. Absolutely.

Chairman **St Germain**. Hallelujah! My time has expired. Mr. Annunzio.

Mr. **Annunzio**. I thank you, Mr. Chairman. I listened to the witness. When you walk into a bank and you have $9,000 and you ask for a cashier's check or a money order, you are not violating any law?

Mr. **Friedberg**. That is correct, sir.

Mr. **Annunzio**. You can repeat that 50 times per day?

Mr. **Friedberg**. Yes, sir.

Mr. **Annunzio**. And you are still not in violation of any law. I want to get this record straight. The chairman asked the question about the employees of the bank asking you about the money, but it is none of their business. They are working there and you pay *x* number of dollars for a cashier's check and they are making money. A bank is in the business of making money. You are in the business of not knowing you are laundering money. I don't think there are many people in the country that know that $10,000 has to be reported. Do you agree with that statement?

Mr. **Friedberg**. Yes, absolutely. I was going to inject that there is an education process. I was educated by the Miami Herald.

Mr. **Annunzio**. You have been through this process. How would you advise the members of this committee. I voted for the $10,000 in the Bank Secrecy Act and it is a good thing that we had the Bank Secrecy Act on the statute books because when this thing came up, it was the only tool that Federal law enforcement officials have for going after the money launderers and the people who were in the drug business. What would you suggest? How do we overcome it?

Mr. **Friedberg**. I found some roadblocks in the Miami area that I would like to pass on to you.

Mr. **Annunzio**. Yes.

Mr. **Friedberg**. We had one bank that when you walked in with a large amount of cash, first, all banks in Miami right now in order to purchase a cashier's check or money order, you must have an account with the bank. They will not sell you money orders or cashier's checks unless you have an account.

Mr. **Annunzio**. That is a step in the right direction.

Mr. **Friedberg**. Correct. Barnett Bank, if I am not mistaken, requires that you first deposit the money in your account and then write a check on it so that they can show the transaction there.

Most people are a little reticent to deposit the money in their own account if you are in the laundering business.

Also, the currency reporting system and certainly $10,000 is a good figure, I think there should be something about unusual cash transactions. Don't you consider it unusual for me to come into your bank three times per week with $9,000 on each occasion?

You do have to report it if it is $10,000 but by law, you don't have to report the $9,000 I think three times in the same week with $9,000 is an unusual currency transaction which should be brought to somebody's attention.

Mr. **Annunzio**. Maybe so, but they are in the banking business to make money. We are a Banking Committee and we have just been through a great deal of bank deregulation because there are too many regulations. There is too much oversight on the part of the Government, people complain.

Our President is one of the most popular Presidents in the history of this country because he wants the Government out of everybody's business.

Now you are here this morning telling me that we have to put the Government in the business of all people. If you need a cashier's check, you have to have an account or you can't get the check. Maybe we could say something like if the person presenting the cash wants a money order of an amount over $5,000 they at least have some sort of identification to identify themselves. But then you are putting the onus on the person who is asking for the check because he might be a legitimate person, and if he goes to one of these lawyers and his civil rights have been violated, then we are back to square one again. That is why we can't get liability insurance, you see. So it is quite a puzzle.

Mr. **Friedberg**. I can sympathize with the situation, Mr. Annunzio. Having lived it, I understand it.

Mr. **Annunzio**. You can sympathize with a Member of the committee. How do you write legislation? You have lawyers on malpractice with doctors. You have lawyers on malpractice with lawyers. You have liability insurance. If you sneeze with some people, they are in court with a civil rights suit. It is a tough problem. My time is up. Thank you, Mr. Chairman.

Chairman **St Germain**. Mr. Friedberg, the picture to the left with the piles of money, does that look familiar to you?

Mr. **Friedberg**. It looks like Mr. Behar's warehouse on a Monday afternoon.

Chairman **St Germain**. Would you describe that to us? I think we need more testimony from you and Mr. Bandstra in order to help the Members.

Mr **Friedberg**. Yes, sir. Mr. Behar started out on a small scale. He had one or two people that he was handling their cash for. He was dealing with a Colombian by the name of Alex and Alex was making contacts here in Miami and sending these people to Mr. Behar.

After Mr. Behar's May visit to Colombia, his business increased tremendously and he picked up a number of other clients. Money would come in to Mr. Behar's warehouse at 2 or 3 o'clock in the afternoon in duffel bags, suitcases and that is a typical picture.

This money would be placed in one of the back offices and Mr. Behar and his employees and his wife would sit and count this money and put it in $10,000 packets so it would make it easier to count.

On an average afternoon, you would have in excess of $400,000 to $500,000. When Mr. Pickle mentioned that $90 billion figure and $50 billion, I was not surprised. On an average day while working for the Government, it was not inconceivable for me to handle $100,000 per day in laundering and that is a half a million dollars and I was just one little guy in Miami just doing that.

Chairman **St Germain**. Tell me. In this warehouse, he was an export/importer?

Mr. **Friedberg**. Yes, sir.

Chairman **St Germain**. Did you have any duffel bags of coffee coming in?

Mr. **Friedberg**. Nothing, sir.

Chairman **St Germain**. No coffee.

Mr. **Friedberg**. Nothing.

Chairman **St Germain**. No Colombian coffee?

Mr. **Friedberg**. No.

Chairman **St Germain**. Juan wasn't there?

Mr. **Friedberg**. No, none at all. In fact, not seeing the denominations we would get money in various denominations and when we would get a load in of small bills, 5's or 10's, it would be referred to as marijuana money and the 20's and 50's and 100's was called cocaine money.

Chairman **St Germain**. Was that before or after your trip to California?

Mr. **Friedberg**. After. This was after Mr. Behar made his contacts in Colombia in June. I started working for the Government in June.

Chairman **St Germain**. Just a quick question to Mr. Bandstra, and then we will go to Mr. Wylie.

We have met Mr. Friedberg and thanks to your cooperation, he is able to speak to us today, even though he has other cases he may be testifying in. How many Mr. Friedberg's were working with Mr. Behar?

Mr. **Bandstra**. Mr. Chairman, Mr. Friedberg was one of approximately 6 to 8 persons that we have identified, persons which subsequently were indicted, some of those cases have been completed and others are still pending.

But Mr. Behar had approximately 6 to 8 persons doing exactly what Mr. Friedberg was doing on a daily basis.

Chairman **St Germain**. So Mr. Friedberg was doing about $100,000 per day; correct?

Mr. **Friedberg**. Yes, sir.

Chairman **St Germain**. Were these other people handling that amount of money, approximately the same amount of money?

Mr. **Bandstra**. To the best of my understanding, it is. Mr. Friedberg, of course, was with them. He met them and he dealt with them. I believe that is correct.

Chairman **St Germain**. Mr. Friedberg.

Mr. **Friedberg**. Yes, sir.

Chairman **St Germain**. So that if there are six of you working on any given day, we are talking about $600,000?

Mr. **Friedberg**. It is entirely possible, sir.

Mr. **Bandstra**. Mr. Chairman, I think it might be helpful also for the committee to know what was done with the checks once they were purchased if Mr. Friedberg could address that question.

Chairman **St Germain**. Oh, great.

Mr. **Friedberg**. We were always to bring the checks back after the close of banks on that day. For example, if I took $125,000 and I laundered $100,000 I would turn in $100,000 to Mr. Behar and he would tally out, so-to-speak, and he would collect all these checks and they would fit into a regular legal size envelope.

On many occasions he had people coming to his office who were leaving for Colombia or Panama that afternoon and on a number of occasions. I personally drove them to the airport or they would be turned over to any of Mr. Behar's employees, myself included, for deposit in bank accounts in the Miami area the following day when we would continue with laundering of money on the next day.

Then Mr. Behar would keep certain checks and turn them over to individuals who gave them to him. I recall Mr. Behar sitting at his desk and endorsing these checks, looking at the name on the front and then forging the name on the back, Mr. Gonzalez or Mr. Gomez or whatever, and then putting them in an envelope.

It got to a point where one of the very large banking institutions in Miami was selling money orders up to $10,000 and we were buying $9,000 money orders and they loved these because there were no dates on them and you did not need a remitter's name or a purchaser's name.

Chairman St Germain. Are you telling us that the bank increased the amount of the money order that you could purchase?

Mr. Friedberg. Yes, sir. Originally, I remember that they were $2,000. They went to $5,000 and AmeriFirst banks of Miami now sell money orders up to $10,000.

Chairman St Germain. What bank was that?

Mr. Friedberg. That was the AmeriFirst.

Chairman St Germain. They must like this laundering business.

Mr. Friedberg. The turnaround time from what I gather when some of these checks were subpoenaed, the turnaround time could be as high as 60 to 90 days and they get $5 for purchasing the money order and then 60 or 90 days turnaround time from the time they sell it until the time they have to pay on it.

Chairman St Germain. Mr. Wylie.

Mr. Wylie. Let me say, Mr. Friedberg, that you are a very unusual witness. It looks like you are in the position to help us get some information that this committee needs.

Mr. Bandstra, is Mr. Friedberg giving us good information?

Mr. Bandstra. Yes, Mr. Wylie. Everything that Mr. Friedberg is telling you has been corroborated by agents of both the Internal Revenue Service and the Customs Service. As Mr. Friedberg said, at one point he came to Federal agencies—first the FBI and then the Customs Service—and reported back—after that point reported back to Federal agencies on a daily basis.

The copies of many of the cashier's checks and money orders which were purchased were turned in and are now evidence and have been evidence in cases that have been presented already in the southern district of Florida.

I would only like to clarify one thing, and that is that Mr. Friedberg said he began working for the United States laundering money. I think it is clear to the committee that he was not laundering money for the U.S. Government.

Mr. Wylie. I would hope not. [Laughter.]

Mr. Wylie. You were employed by Mr. Behar?

Mr. Friedberg. Yes, sir.

Mr. Wylie. How were you paid?

Mr. Friedberg. Mr. Behar, starting in June—just at the same time I started working for the Government—started to pay 1 percent commission. It was my understanding Mr. Behar was collecting 4 percent on the money and paying 1 percent.

Mr. Wylie. So if you—how much money could you launder in a day?

Mr. Friedberg. $100,000 a day.

Mr. Wylie. $100,000.

Mr. Friedberg. Yes, sir.

Mr. Wylie. And you got 1 percent of that as your fee?

Mr. Friedberg. That is correct. Less expenses, of course.

Mr. Wylie. Less expenses. You had to take care of them out of your own pocket?

Mr. Friedberg. Correct.

Mr. Wylie. Where is Mr. Behar now?

Mr. Friedberg. It is my understanding that Mr. Behar has been sentenced. I do not know if Mr. Behar is presently——

Mr. **Bandstra**. Mr. Wylie, Mr. Behar was indicted in four separate indictments in the southern district of Florida because he was involved in four separate conspiracies. He has plead guilty in each of those cases and has now been sentenced by all four Federal district court judges. And it was my understanding that he either was to report to the Federal Bureau of Prisons this week or next week.

Mr. **Wylie**. What was he charged with?

Mr. **Bandstra**. He was charged with conspiracy to defraud an agency of the United States, the Internal Revenue Service.

Mr. **Wylie**. Tax evasion?

Mr. **Bandstra**. It was not tax evasion. He has a problem with the Internal Revenue Service that has not yet been worked out. But he was actually charged with a violation of title 18, conspiracy to defraud an agency of the United States.

Mr. **Wylie**. Is it usual for a Smurf to take the money and run or are Smurfs part of an organized crime effort? Just how does the Smurf get into this kind of operation? I understand how you got into it.

Mr. **Friedberg**. First, I found it was very unusual for an American to be involved in it. Again, my only contact in the Miami area, most of them were Latin. Colombians. And to let an American handle their money was unheard of.

Most of the Colombians I had come in contact with, through working, nobody ever ran. They could probably make more money on a Smurfing basis than just taking whatever they were given.

Also, I was given larger sums of money than the average Smurf would take in a day, I would imagine. Except for Mr. Behar's close associates, most of them that I have met will tell you they get $50,000 or $60,000 a day. And that's 5 days work or 2 weeks work, I would say. They would be better off keeping Smurfing than run with the $50,000 or $60,000.

Mr. **Wylie**. So they are usually a part of an organized crime effort, Mr. Bandstra?

Mr. **Bandstra**. In the sense that this is very much an organization. I think it is also clear, from Mr Friedberg's testimony, they were talking about individuals who are at various levels in a money laundering organization. There is a person at the top, who in this case was identified as "Alex," who was in Colombia and who presumably has contacts in Columbia with persons who are either directly supplying cocaine into the United States or is somehow involved with the supply of that cocaine into the United States.

Then there are persons in the United States, such as Mr. Behar, who might be considered as money exchangers for a drug smuggler in Colombia. Mr. Behar was one of the persons that Mr. Friedberg worked for. He also had contacts with other such money exchangers who were also indicted in the southern district.

On the bottom level of this three-tiered money laundering scheme would be the Smurf, the person who is referred to as a Smurf, and those are the persons actually running to the banks to do these deliveries. The whole purpose, of course, is to get the money usually outside the United States. There are times when money is deposited in the United States, or investments are made in the United States, but ordinarily this money is taken in the form of these negotiable instruments outside the United States.

Mr. WYLIE. Did these institutions ever ask you for any identification?

Mr. FRIEDBERG. In Miami, yes, sir. In California, no, sir.

Mr. WYLIE. In California they did not?

Mr. FRIEDBERG. Not at all, sir.

Mr. WYLIE. Did they ever ask where you got that much money?

Mr. FRIEDBERG. No, sir; the only problem I ran into in California was this was 1984. It was in May 1984, just prior to the Olympics, and the only concern one bank showed was that there was possibly counterfeit money there. So the entire $9,000 was put through a counterfeit checking machine. That was the only problem we ran into. It slowed me down for about 25 minutes.

Mr. WYLIE. Thank you, Mr. Friedberg.

Chairman ST GERMAIN. Laundering $100,000 a day, you must have had to run.

Mr. FRIEDBERG. I gained weight since I stopped, sir.

Chairman ST GERMAIN. Mr. Barnard.

Mr. Barnard is quite a runner. If you have noticed, he is nice and slim. He runs every day.

Mr. BARNARD. I never made that much money running, though, Mr. Friedberg.

Mr. Friedberg, were your instructions very general, that you just were supposed to go to banks, or did you have—were you instructed to take advantage of money exchanges or any other type of operation?

Mr. FRIEDBERG. No, sir; strictly banks.

Mr. BARNARD. Strictly banks. Did any of your transactions take the form of buying travelers checks?

Mr. FRIEDBERG. No, sir.

Mr. BARNARD. Only cashier's checks?

Mr. FRIEDBERG. Cashier's checks or money orders.

Mr. BARNARD. I see. And as you said, as you listed the various banks in California with only Florida identification, you never confronted any question about your purchasing of cashier's checks?

Mr. FRIEDBERG. None whatsoever. The entire $200,000 was accomplished in a day and a half. Just for the record, neither one of us—Mr. Yuribi, who was with me, and whose command of the english language is very poor—we had no idea where we were.

Part of the story, I think, is very interesting. We landed at the airport and we leased a car and it was at night. We were pulling out of the airport and at the car leasing agency, we asked where are there a lot of banks. He said, "What do you mean?" I said what neighborhood, a nice neighborhood where there are just banks. So he said, "Why do you not try Wilshire Boulevard."

Now you have to remember we have no idea where we are. We are two Floridians, this is about 9 or 10 at night. We are in a strange town on the other side of the country, and we drove to Wilshire Boulevard. We found a motel. This was on a Saturday. We checked into the motel.

Chairman ST GERMAIN. What name did you use on the car or the motel?

Mr. FRIEDBERG. Our name, sir.

We subsequently have gone out to California and it was also corroborated that the hotel was registered in the name of Mr. Yuribi. He used his credit card. The car was rented in my name because I was the driver and Mr. Yuribi was frightened to death to drive on California roads. [Laughter.]

Another interesting story, Mr. Bandstra just reminded me, when we made this contact, we went out to Palos Verde, if you are familiar with the area, it is a very, very high rent neighborhood.

Chairman **St Germain**. I know no more about that area than you knew about Wilshire Boulevard.

Mr. **Friedberg**. Well, I can tell you this, it overlooks the Pacific Ocean and it is magnificent. We went into this beautiful house and you can see from the front door right out through the back window. The reason you could was all there was mattresses on the floor. There were no furnishings, there were sheets over the windows.

He mentioned he was paying $2,500 a month rent for this house. The money was laid out on a dining room type table with a couple of chairs around it.

Other than having a gymnasium in the basement where he worked out, that is all there was in this house in Palos Verde.

Mr. **Barnard**. Did he have any money under those mattresses?

Mr. **Friedberg**. I didn't check, sir. We were there a week late. Had we come a week earlier, he would have had the full $400,000.

But one of the points that was made, I think was very interesting, that he never asked for any identification. He had never saw us before in his life, and he turned over $200,000 to us.

Mr. **Barnard**. So Mr. Friedberg, when you got back to Florida, after that trip, then you were ready to read the newspaper, right?

Mr. **Friedberg**. No, sir; I was ready to resign because nothing was right on that trip, at all. I realized that, at this point, something was wrong. The demeanor of the gentleman that we picked up the money from, he had another associate with him. There were two people really involved, and some of the comments Mr. Yuribi made.

It was the first opportunity I had to be alone with Mr. Yuribi, who was Mr. Behar's associate. We shared a room together for Saturday night, Sunday night, and Monday night. I learned an awful lot.

Then, of course, the newspaper corroborated what I had learned.

Mr. **Barnard**. I am going to ask you an embarrassing question and that is did you file an income tax return for the money that you earned?

Mr. **Friedberg**. Absolutely, sir.

Mr. **Barnard**. How did you designate that money as income?

Mr. **Friedberg**. I think I put down money laundering, sir. [Laughter.]

Mr. **Barnard**. You did? You put that on the IRS form?

Mr. **Friedberg**. Absolutely.

Mr. **Barnard**. The IRS didn't catch it?

Mr. **Friedberg**. No; it was done under the auspices—you have to remember I was working for the IRS.

Mr. **Barnard**. That is right, you started in January.

Mr. **Friedberg**. That is correct. I was working for the IRS.

Mr. **Barnard**. I am not surprised.

Mr. **Friedberg**. By the way, just for the record, Mr. Barnard, everything I earned was turned over to the Government.

Mr. **Barnard**. Oh, I see.

Mr. **Friedberg**. From June on, everything was turned over.

Mr. **Barnard**. One further question—I think my time is about up.

Did you develop any friendships, any acquaintances, with these other members or other people who were helping whatever his name was?

Mr. **Friedberg**. Mr. Behar?

Mr. **Barnard**. Yes; but you all had a little team going there, so I didn't—did you——

Mr. **Friedberg**. One of the problems was that I was an outsider. I was an American and they were all Latins and there was—as a matter of fact, we did socialize to the extent that we would have lunches together and things like that.

Mr. **Barnard**. But you did know one another?

Mr. **Friedberg**. Yes, sir.

Mr. **Barnard**. What happened to the rest of those gentlemen?

Mr. **Friedberg**. I think Mr. Bandstra can answer that.

Mr. **Bandstra**. I believe it is 28 persons, Mr. Barnard, 28 persons out of this entire scheme being operated by Mr. Behar were indicted. I believe 26 of those or 25 of those have now either plead guilty or have been convicted.

Mr. **Barnard**. But Mr. Friedberg was the only innocent victim there? I mean, the rest of them knew what they were doing?

Mr. **Bandstra**. Yes.

Mr. **Barnard**. Thank you very much.

I appreciate your being here today, Mr. Friedberg.

Mr. **Friedberg**. Thank you, sir.

Chairman **St Germain**. Tell me something. This warehouse, did it have a security force around it?

Mr. **Friedberg**. None whatsoever.

Chairman **St Germain**. Really? Because you know, I have read some of the stories about the shoot-outs they have. They have got sophisticated weapons and all.

Mr. **Barnard**. You have been watching too much "Miami Vice." [Laughter.]

Mr. **Friedberg**. The only security Mr. Behar had, he had a metal door which you raise up and down. When a money delivery was made he would raise the door, the car would pull in, and then close the door behind them. There were never any weapons or anything of that nature.

People delivering the money would wait until the money was counted and then they would leave. Then Mr. Behar would divide the money up. Usually, within 2 to 3 hours, everything was gone from the warehouse, dollar-wise, it was all split up. The following day it was brought back in the form of checks.

Chairman **St Germain**. Prior to your trip to California you did, on a given day, launder $100,000?

Mr. **Friedberg**. No, sir. Prior to that, Mr. Behar's business was very small. Mr. Behar and Mr. Yuribi and Mrs. Behar were all working. I think the largest amount I had seen prior to that was $50,000 and that was on one occasion.

Chairman **St Germain**. But you never saw any weapons whatsoever.

Mr. **Friedberg**. No, sir.

Chairman **St Germain**. Did you ever feel funny walking out of that warehouse to go launder $100,000?

Mr. **Friedberg**. Scared to death.

Chairman **St Germain**. I would have been, too.

Mr. Kanjorski.

Mr. **Kanjorski**. Yes, Mr. Chairman, a few questions.

Mr. Friedberg, I read over your prepared statement and I appreciate your coming here to testify, but I find it incredible that before June 1984 you had no suspicion that there was something wrong. Is that what you really want us to believe? Or is June that you realized that you were in trouble and you had——

Mr. **Friedberg**. No, sir; I had no problem. I was never investigated. I never had any——

Mr. **Kanjorski**. It is not a question of whether you were investigated. You mean up until June, for 5 or 6 months, you were——

Chairman **St Germain**. If the gentleman would yield.

That was explained previously so what I think you should do is tell him the story Mr. Behar gave you, as to where this money came from.

Mr. **Kanjorski**. I have read the statement.

Chairman **St Germain**. Pardon?

Mr. **Kanjorski**. I have listened to the testimony and I have read the statement.

Chairman **St Germain**. Were you here when he explained the con job on him?

Mr. **Kanjorski**. Yes; I just find that that was not a convincing con job and I am just wondering why you accepted it and I would not.

Mr. **Friedberg**. I cannot answer the question, sir, other than the fact that Mr. Behar was convincing and I——

Mr. **Kanjorski**. Let me ask you, I was a workman's compensation referee before I came to the Congress and I tend to agree with the chairman. I found very few people who were seriously injured who do not contest being laid off workman's compensation. You never made a contest of this?

Mr. **Friedberg**. I had a back injury which was healed in December and that was it.

Mr. **Kanjorski**. How were you paid for the first 5 months, from January 1984 until June 1984, when you went to the FBI?

Mr. **Friedberg**. Mr. Behar was paying me on a per day basis. He would pay me $100 or $150.

Mr. **Kanjorski**. Did he give you a check or cash?

Mr. **Friedberg**. No, cash.

Mr. **Kanjorski**. Cash?

Mr. **Friedberg**. Yes, sir.

Mr. **Kanjorski**. Is that normal operation?

Mr. **Friedberg**. Absolutely.

Mr. **Kanjorski**. Then obviously, since you were in business of some sort, you must have filed a quarterly return with the IRS in April and in June of that year on your income.

Mr. **Friedberg**. No, sir. I filed my first one in June, not in April.

Mr. **Kanjorski**. After you went to the FBI and the IRS?

Mr. **Friedberg**. When I was informed that I had to do it. I was not aware of quarterly returns.

Mr. **Kanjorski**. You mean you are 53 years old and you did not know that if you were self-employed business you have to——

Mr. **Friedberg**. I never was self-employed prior to that.

Mr. **Kanjorski**. In your prepared statement, you talk about the fact, on page 4, page 5, that your employer was indicted in February of 1985, is that correct?

Mr. **Friedberg**. Yes, sir.

Mr. **Kanjorski**. And that in mid-May 1985 he returned from Colombia and expanded his business after he was indicted?

Mr. **Friedberg**. It could be a typographical error.

Mr. **Bandstra**. If the statement says that, it would be incorrect. It is mid-May 1984 that he returned from California.

Mr. **Kanjorski**. Are there a lot of people in the State of Florida who operate being paid on a daily basis with cash, and they don't realize that they have to file returns and they go around setting up nine bank accounts without any money so they can cash checks, and they don't suspect that there is something wrong with that?

Mr. **Friedberg**. I am sure there are.

Mr. **Kanjorski**. What would you have the Congress do to cure a problem like this?

Mr. **Friedberg**. I don't have the expertise to answer it, sir. I truly don't. I know that to make it more difficult for these people, you are also making it more difficult for the innocent people, I realize that.

Mr. **Kanjorski**. Mr. Bandstra, what were the sentences of these 26 people that were indicted?

Mr. **Bandstra**. The sentences have been, in my opinion, very light.

Mr. **Kanjorski**. Well, I didn't ask you that. I asked what the sentences were.

Mr. **Bandstra**. The sentences? The sentences have been between 3 and 5 years.

Mr. **Kanjorski**. And upon whose recommendations were they this way. Were they worked out pleas?

Mr. **Bandstra**. In most cases there were no restrictions on the judge—on the district court judges above a certain limit. I might say that in certain cases there were plea agreements entered into with these defendants, in all cases not less than 10 years, except perhaps one in which the restriction—or in which the agreement was a 5-year cap.

Mr. **Kanjorski**. They were given 10-year sentences in each——

Mr. **Bandstra**. No. Many of these individuals were indicted in multicount indictments.

Mr. **Kanjorski**. Yes.

Mr. **Bandstra**. Many of these individuals entered into plea agreements with the U.S. Attorney's Office, in which they pled guilty to two counts, or three counts; each of these counts being a

5-year count, so that they were exposed to a maximum penalty of 15 years or 10 years, but——

Mr. **Kanjorski**. But what was the understanding as to, in fact, what they would receive.

Mr. **Bandstra**. I am sorry, I didn't hear the question.

Mr. **Kanjorski**. What was the understanding as to, in fact, what they would receive?

Mr. **Bandstra**. There was no understanding, and it would be improper for there to be any kind of a discussion or an understanding on the part of the defendant.

Mr. **Kanjorski**. What did they then receive?

Mr. **Bandstra**. They then received between 3—well, I would say between 2 and 5 years.

Mr. **Kanjorski**. And did the Attorney General of the United States raise cain with the Federal bar as to the reason that they were leaving these people out of a third of their sentence?

Mr. **Bandstra**. No; not to my knowledge, sir.

Mr. **Kanjorski**. Was this passed upon by the Attorney General's Office here in Washington?

Mr. **Bandstra**. The plea agreements themselves?

Mr. **Kanjorski**. Yes.

Mr. **Bandstra**. No; they were approved as is the case in every case, they were approved within the U.S. Attorney's Office in the southern district of Florida.

Mr. **Kanjorski**. Mr. Chairman, I suggest maybe we should talk to some of the Federal attorneys in the State of Florida.

Chairman **St Germain**. Mr. McKinney.

Mr. **McKinney**. Thank you, Mr. Chairman. Mr. Bandstra, I would have to be rather complimentary. I have watched you guys try to shovel sand against the tide in southern Florida for most of my life, and the tide gets higher all the time, I think, Mr. Chairman, you have the most beleaguered force of U.S. agents and U.S. attorneys and assistant attorneys in southern Florida.

Unfortunately, my old home town isn't what it used to be.

One of the things that really fascinates me, Mr. Friedberg, is why not just cancel cashiers checks? Why not just force a bank to require a personal check, which they can charge the same fee for, and they will. In fact, certify that check as being worthwhile, but that way we get away from the innocuous no-name instrument pretty much, right?

Mr. **Friedberg**. Yes, sir.

Mr. **McKinney**. Interesting. Of course, that brings horror to the banker's eyes, but it is a beginning. Florida is a strange place. I bought a place in West Palm Beach, way west, and I went down there during the mortgage crunch when none of my constituents, including a Congressman, could get a mortgage any more. They were still building like mad. I asked my real estate broker: Who is taking out all these mortgages?

I got this blank look from this young lady, who just simply said: Mr. McKinney, there are only 16 mortgages in this whole condominium complex, and you have one of them.

That makes a northeasterner's teeth vibrate a little bit. I said: You mean everything is being paid for in cash?

And she said: Oh, yeah.

And guess what language you hear out at the swimming pool?

Mr. **Friedberg**. Absolutely.

Mr. **McKinney**. OK. You are walking on dangerous territory, but Florida is the land of cash, and I don't know how you guys are going to do it but somehow or other, we have to do something about no-name instruments—cashier's checks and cash. It sounds ridiculous to say you are going to be hard put to use the Nation's currency, but that is really what we are talking about, because cars are paid for in cash, condominiums are paid for in cash, and then they turn around and sell those things. It is a go-go market. You can sell for 5 or 10 percent more than you even paid.

Let me ask you a question. This is a very personal question. You are in Los Angeles and a guy hands you $200,000. Now, where I come from that is a heck of a lot of money.

Did you ever get the urge to just take a walk?

Mr. **Friedberg**. If the thought came to my mind, it didn't linger there too long.

Mr. **McKinney**. OK. Now, in other words, you sort of feel something might happen to you if you did take a walk. What did you think would happen to you? Did you think Mr. Bandstra and the Feds, or the locals would come after you, or did you think someone on a dark night might just end it all?

Mr. **Friedberg**. Well, here again having a family who lived in Miami, and it is someone else's money, whether I considered him a gangster or racketeer, I would have to feel that he would be a little upset if I walked away with $200,000 of his money.

So, therefore, the thought never lingered that long.

Mr. **McKinney**. Yeah, but I mean gee, what a temptation. Two hundred thousand cash, and nobody is going to follow you like the Feds would try to follow you to Argentina or any of those places.

I mean, you can just take a walk. I suppose, Mr. Chairman, if you steal the money, you really don't care that much.

Chairman **St Germain**. Yeah, but he probably has a wife and children and so forth. Leave them behind?

Mr. **McKinney**. That is what I wanted to really get across was, you know, this is a lot of cash, and people are just sort——

Mr. **Friedberg**. If I didn't like my wife it would have been a great opportunity.

Mr. **McKinney**. You know, nobody knows better than Mr. Friedberg or Mr. Bandstra, that all one has to do is read the Miami News on a daily basis, and a lot of people bite the dust for a lot of reasons, including, unfortunately, our poor FBI agents recently.

You know, it is a real problem, but it is the heart of the drug business. Without money laundering, the drug business isn't worth the time, the effort, or the danger, but with money laundering it is worth so much that the people don't give a darn any more.

If you lose $1 million Hatteras yacht, so what? You made $6 million on the sale. You launder it. I really appreciate your testimony, and I appreciate your forthcoming responses.

Let me ask you another inner question. When you look in the mirror in the morning, and you looked at that, and you knew how many people were working in your little outfit with no guards at the door, with cash lying all over the place, wasn't there a lot of that going on in your mind?

Mr. FRIEDBERG. I could not believe myself how much was going on. Once you get into the inner workings of it, one of the exercises, you would be going into a bank and you would be waiting in line, and you see familiar faces, and you think it is somebody you know, and then you realize it is the same Smurf that you have seen in the previous bank.

Mr. MCKINNEY. He was laundering $9,000 too?

Mr. FRIEDBERG. You are running a route. That is what it amounts to I think you might enjoy how it was done. I would take home $100,000, and when I would get home I would put it out on my dining room table and break it down into $9,000 packages.

Mr. MCKINNEY. You mean your wife could sit still and watch $100,000.

Mr. FRIEDBERG. No. My wife cried.

Mr. MCKINNEY. My wife would go certifiably insane, instantaneously.

Mr. WYLIE. Would the gentleman yield?

Mr. MCKINNEY. Yes.

Mr. WYLIE. You have a lot of income for a short period of time here, and now don't have it. Where are you employed now?

Mr. FRIEDBERG. I am not, sir.

Mr. WYLIE. You are out of work?

Mr. FRIEDBERG. Yes, sir.

Mr. WYLIE. And you are not earning a livelihood?

Mr. FRIEDBERG. No, sir.

Mr. WYLIE. OK, thank you.

Mr. MCKINNEY. My time has expired, but if you want to keep up. You just took the money home and threw it on the dining room table.

Mr. FRIEDBERG. We broke it down into $9,000 packages, and then I would make a list of the banks I was going to call on the following day, and you had bags—bank bags, these plastic bags, and you put the money in there and put it all in an attache case, and contrary to what they show on television, at attache case does not hold $1 million; it holds about $120,000 in 20's.

Mr. MCKINNEY. Mr. Chairman, you have to be heroic to be a Federal employee in a land like southern Florida, and I congratulate the Fed's informant, and I congratulate the assistant U.S. attorney.

Chairman ST GERMAIN. You said your wife would cry when she saw you counting the money into the packets?

Mr. FRIEDBERG. She just couldn't believe the kind of money that would just come in every day, and she would walk out of the room. She didn't want to even sit there and watch.

Chairman ST GERMAIN. Did she know after June that you were——

Mr. FRIEDBERG. Oh, absolutely. I told her immediately.

Chairman ST GERMAIN. Mr. Wortley.

Mr. WORTLEY. Thanks, Mr. Chairman. Mr. Friedberg, the principal bank that you used for laundering operations, how long had you had an account in there when you first started laundering?

Mr. FRIEDBERG. The very first check I made was on my own bank account, and it was in the form of a personal check which Mr. Behar had asked me for, and it was in the amount of $5,000, and I had been banking—that was Pan American Bank, and I banked there from 1973 through 1984, when I went to work for Mr. Behar.

Mr. **Wortley**. Did you usually bank with the same tellers in there, or was there a lot of turnover?

Mr. **Friedberg**. As banks are, you know you do get turnovers. However, there were some regular tellers which I saw the entire year.

Mr. **Wortley**. Were there some bank officers that you regularly knew? Did you ever need accommodations at the bank? Buy a car, or take a short term note?

Mr. **Friedberg**. With Pan American I did. I had some loans with Pan American Bank.

Mr. **Wortley**. So, you did have a relationship with the officer or the manager of the bank?

Mr. **Friedberg**. That is correct.

Mr. **Wortley**. Now, when you started playing this money laundering game, was there ever any comment between you and the manager at all?

Mr. **Friedberg**. No, sir.

Mr. **Wortley**. Do you think the manager was aware that you were playing games?

Mr. **Friedberg**. I would have to believe that when you see me once a week in your bank, always with cash and always in the amount of $9,000, even if you don't personally see the transaction, that the teller has to report you. Here comes that guy again with the $9,000.

The only complaint the teller ever had was the time that you took for them to count the money.

Mr. **Wortley**. The other Smurfs that seemed to operate out of the same headquarters, were they casual people involved in this thing, or do you think they were part of the organized crime operation?

Mr. **Friedberg**. I think they were Mr. Behar's employees. I can't describe their status other than that.

Mr. **Wortley**. You think they were regular employees?

Mr. **Friedberg**. Yes, sir, they were.

Mr. **Wortley**. As opposed to you? You were kind of a commission merchant, is that right?

Mr. **Friedberg**. Everybody was on commission.

Mr. **Wortley**. Everybody was.

Mr. **Friedberg**. Everybody was on commission.

Mr. **Wortley**. How many Smurfs do you think were operating in southern Florida?

Mr. **Friedberg**. I couldn't even give you a figure. Just with Mr. Behar's small organization. Again, there isn't a day when you wouldn't go into a bank where you wouldn't see a familiar face, someone who you saw on a regular basis in a bank some other time, and he was doing the same thing which you were. Or she was.

I recall when I was working for the Government, there were two ladies in a particular bank, and I was watching them. They had two separate windows, and both were cash, and I called up the agents, and we just missed them at the bank, but we did get their license plate number, but each one had brought checks in the amount of $9,000.

And then I saw them one-half hour later leaving another bank.

Mr. **Wortley**. Now, let's move to the next stage. You said from time to time you would see at Mr. Behar's—an individual who was going to travel off shore someplace.

Mr. **Friedberg**. Yes, sir.

Mr. **Wortley**. Would these tend to be the same people who would be coming in from time to time?

Mr. **Friedberg**. Not necessarily.

Mr **Wortley**. Not necessarily?

Mr. **Friedberg**. Not necessarily.

Mr. **Wortley**. But in some cases they were the same people.

Mr. **Friedberg**. Yes; he had some—same man who came in on two or three occasions.

Mr. **Wortley**. Do you think they worked on the same commission basis you did, didn't you ever have a chance to compare notes?

Mr. **Friedberg**. I had no idea. Never spoke with them, they didn't speak English, and it was merely a situation where they would come into the office and either leave, or Mr. Behar would say, can you give him a lift to the airport or can you drop him off at a motel or hotel somewhere.

Mr. **Wortley**. How big a package of cashiers checks would they walk around with?

Something that they would put in their pocket?

Mr. **Friedberg**. You could put it in your inside jacket pocket in the amount of $300,000 or $400,000 without any problem.

Mr. **Wortley**. All right. Did you ever wonder how that money recycled, and did you ever have any indication of what ultimately happened to it? You knew it went off shore, went to another bank. Did Mr. Behar ever talk about the money he was recycling back into the system? He bought property, he bought stocks and bonds?

Mr. **Friedberg**. Mr. Behar never discussed it, sir. In fact, he kept pretty much to himself. Subsequently, I think the Government has found out the route some of the money had taken, but as far as Mr. Behar telling you what happened to the money, he was silent on that.

Mr. **Wortley**. Mr. Bandstra, can you tell us what you know about the cycling of the money?

Mr. **Bandstra**. Mr. Wortley, only to know that certain of these checks—the route of these checks was traced to banks outside the United States. Banks in Panama.

Beyond that, I can't comment. And I might also add, Mr. Wortley, that in this case, in a usual case, there is not a lot of discussion about the drug connection relating to this money that is being laundered.

In fact, most persons who were laundering money would probably deny that they are in any way involved with the narcotics trade. And that was certainly the case in this case.

Mr. Behar today would not say, and I have talked with him myself, would not say that he was in any way knowledgeable that this was drug money.

Mr. **Wortley**. Where did the money come from? Was it numbers' money? It had to come from some place.

Mr. **Bandstra.** When I asked him that, he would be that he didn't know, he didn't ask, he didn't care.

Mr. **Friedberg.** If I might add, Mr. Behar was a resident of a very luxurious condominium, of which I was the manager. Mr. Behar's apartment was in the neighborhood of $350,000. A gentleman from Colombia had made application to purchase an apartment in the building. Mr. Behar was one of the first to object on the grounds that he thinks the man is a drug dealer. [Laughter.]

Mr. **Wortley.** My time has expired. Thank you very much.

Chairman **St Germain.** When you counted these packets out, what were the denominations?

Mr. **Friedberg.** They would range anywhere from $5 to $100 bills. In most cases, they were $20 bills.

Chairman **St Germain.** These tellers you dealt with once a week, with $9,000, and the next one doing the same, do they believe in the Tooth Fairy, the Easter Bunny and Santa Claus?

Mr. **Friedberg.** Religiously.

Chairman **St Germain.** They must have. Let's be honest. When you went to this teller for the third time in a month, you must have said to yourself, this is a real crazy, not to ask me where all this cash is coming from. Either their IQ's are about 75 or they are purposely looking the other way.

Mr. **Friedberg.** I would have to believe that, sir.

Chairman **St Germain.** Wouldn't you assume that they would say to the manager: "Hey, this character is coming in here three to five times a month with $9,000 on the button, he must be doing something wrong, otherwise, why would he keep it at $9,000?"

The thought occurs to me that you probably gave us the answer—they were playing the float. They thought it was delightful.

Mr. Bandstra, what is your reaction?

Mr. **Bandstra.** Mr. Chairman, I might add, just because I have had conversations with agents of the Internal Revenue Service relating to this, who are most familiar with the filing of CTR's, that there are banks in the Miami area and perhaps more so of late, that are concerned with these large amounts of money coming in.

I would imagine it would be the response of a bank teller that it is not their business and they have no obligation to file a report, if it is less than $10,000, so they don't ask. However, I do know there are banks that make it a regular practice of filing CTR's and getting the information required for a CTR, even if it is less than $10,000.

I don't think it is quite fair to paint a picture here that all the banks are simply looking the other way or on the take somehow.

Chairman **St Germain.** Mr. Friedberg stated that after a period of time, the banks increased the amount of money orders that you could buy. Did anyone from your office query these banks as to why they made this decision to increase the amount of a money order?

Mr. **Bandstra.** Not to my knowledge.

Chairman **St Germain.** You don't think that would be a rather important question to ask them? Doesn't this facilitate the operation for the money launderers and doesn't this increase the profit to the banks?

Mr. **Bandstra**. In my opinion, yes; it would facilitate it.

Chairman **St Germain**. Why didn't anyone from the U.S. Attorney's Office ask that question of the banks?

Mr. **Bandstra**. I don't know that it wasn't asked. I just don't know that it was.

Chairman **St Germain**. Could you find out for us?

Mr. **Bandstra**. I certainly can.

Chairman **St Germain**. Could you for the record submit a statement as to what the replies were from the banks that increased the denominations of their money orders?

Mr. **Bandstra**. I would be pleased to, Mr. Chairman.

Chairman **St Germain**. Could you also ask what the float has been in these banks, even though they are innocent, having profited from the floats?

Mr. **Bandstra**. I will do my best to find out the answers.

[In response to the request of Chairman St Germain, the information was submitted for the record by Mr. Bandstra and can be found in the appendix.]

Chairman **St Germain**. Thank you. Mr. Parris.

Mr. **Parris**. Mr. Friedberg, have you been a Florida resident for some time?

Mr. **Friedberg**. Since 1972, sir.

Mr. **Parris**. Where did you live before that?

Mr. **Friedberg**. New York City.

Mr. **Parris**. Did you retire?

Mr. **Friedberg**. No, sir, I moved to Florida; worked down there.

Mr. **Parris**. What did you do?

Mr. **Friedberg**. I was in property management.

Mr. **Parris**. You are now unemployed?

Mr. **Friedberg**. Yes, sir.

Mr. **Parris**. I understand you had some kind of injury. Are you off workmen's compensation?

Mr. **Friedberg**. Yes, sir.

Mr. **Parris**. Are you a person of some substantial assets?

Mr. **Friedberg**. Because I had to sell my home—I did own a condominium in Florida, which I sold. I did have some savings which I live on. It is very difficult to account for the 2 years of my time that I was involved with the Government, year and a half with the Government. During the past year, with all the pre-trials and trials and having to be in various places, it is very difficult to get a permanent position.

Mr. **Parris**. You had expenses of your own in all of that; did you not?

Mr. **Friedberg**. I paid all expenses. I have received nothing from the Government for the past year.

Mr. **Parris**. You paid all of that?

Mr. **Friedberg**. The last thing the Government did was transfer me to another State, which I now live in. I am not under any witness protection program, which is my choice.

Mr. **Parris**. Where do you get money from now to pay rent and buy groceries?

Mr. **Friedberg**. I have gone through a very substantial part of my savings.

Mr. **Parris**. You flew up here for this hearing, I gather.

Mr. **Friedberg**. Yes, sir.

Mr. **Parris**. Did you buy your ticket?

Mr. **Friedberg**. I put it on my credit card.

Mr. **Parris**. That is commendable, Mr. Friedberg.

Mr. **Friedberg**. I intend to be reimbursed for it, sir.

Chairman **St Germain**. The Chairman would state that the committee is going to reimburse Mr. Friedberg, as we do for other witnesses.

Mr. **Parris**. That is very gracious of us, Mr. Chairman. [Laughter.]

Chairman **St Germain**. We even send Congressmen on trips and the committee pays for it.

Mr. **Parris**. I have heard of some of those. I have never been on one myself. I understand that is the case.

Chairman **St Germain**. This chairman has been on three in 26 years.

Mr. **Parris**. Let me ask you a serious question. I do not mean to invade your privacy, Mr. Friedberg. You are to be commended for what you have done in the interest of justice and the prosecution of criminal activity, as the chairman and others have alluded to. I was intrigued by the fact that it is impossible to believe that people would not pursue where you came from with this cash. I just find that incredible.

Has any institution or employee ever turned you down when you walked in and said, here's my usual $9,000?

Mr. **Friedberg**. Never.

Mr. **Parris**. Thank you very much, Mr. Chairman.

Chairman **St Germain**. Mr. Bandstra, let me ask you a question. You are a teller in a bank. Mr. Friedberg comes in four or five times a month with $9,000 that he converts to cashier's checks or money orders. Would that not ring a bell with you?

Mr. **Bandstra**. In Miami, I don't think it would ring a bell. Not only because Miami is such a drug center in the United States, but there is, as I believe Mr. McKinney was saying, a great deal of the business done in Miami is done with cash. It is not at all unusual particularly to have foreign individuals in the United States with large amounts of cash. They have come into Miami from other places. They have come often times with their life savings. For some reason, they have a lot of cash.

Chairman **St Germain**. Does Mr. Friedberg look and sound foreign to you?

Mr. **Bandstra**. No; he would not.

Chairman **St Germain**. I repeat my question. Mr. Friedberg is coming in three to five times a month and converting $9,000. No. 1, you look at him, you look at his watch, and you look at his clothes. Does he look like a man that has hundreds of thousands of dollars?

What American operates with that kind of cash?

Mr. **Bandstra**. Other than persons self-employed on a small basis, and even then, it would be unusual.

Chairman **St Germain**. If they are self-employed on a small basis, there are exceptions, granted, by the regulatory agencies, and by IRS. You have a car wash. You have a race track. You have a cleaning business where most of it is done in cash. That's one thing.

Why is Miami so different? Why would you say Miami should be so different that there should be so much cash, legal cash?

Here is Mr. Friedberg, in a regular suit, with nothing big on the watch. He doesn't look like a multimillionaire to me. I don't think he looks like that to you. I repeat my question. He comes in four or five times a month with $9,000, month after month. You would not be suspicious at all?

Mr. **BANDSTRA**. No, I believe I would, Mr. Chairman. I did not mean to convey I wouldn't be. I would be suspicious.

Chairman **ST GERMAIN**. Very sincerely, the aggregation problem is one that we are facing here in addition to the attitude that you had when you said to me, "I'm concerned about these banks." We had the Bank of Boston hearing, where this woman in the south end of Boston was receiving these gunny sacks full of money from the same people, who by the way, had been written up in the papers, the Anguilo's. Have you heard about them? They have been convicted.

For years and years, everybody in that district of Boston knew what type of characters these were and never did the lady who managed that branch ever call anybody in the main office and say, "I have all this cash coming in." As a matter of fact, they had an exception, because they said they were collecting rents.

I have to feel that these institutions have a little more responsibility than to just assume that you have foreigners coming in with all kinds of money and a lot of legitimate businesses. If they are legitimate, they should be registered for an exception.

Mr. Torres.

Mr. **TORRES**. Thank you, Mr. Chairman. You have been most generous in allowing me time to participate on your subcommittee, of which I am not a member. However, I do serve on the main Banking Committee. As the committee knows and the subcommittee knows, I have introduced legislation, H.R. 4280, which attempts to amend title 31, United States Code, to establish new recordkeeping and reporting requirements, in order to combat money laundering, to act as a deterrent to the kind of situation you are familiar with, Mr. Friedberg.

You will notice that when you ask the car leasing company which was the best neighborhood to do business in, they pointed to Wilshire Boulevard. Mr. Chairman, that is not my district. You know where I am from.

I am concerned that Los Angeles has now reached a peak, perhaps in the country, as being the top city now involved in money laundering, perhaps passing Miami now. This is the reason for this kind of legislation.

In your response to a Member of the subcommittee, when he asked you, what do you think could be done about this, you said you didn't have an idea. I am going to ask a question that maybe you could comment on.

My legislation specifically puts a limit on the amount of money that can be brought in by a person like yourself, under the $10,000 provision. My bill calls for $3,000. That is, anyone coming off the street with $3,000 or more and attempting to launder money, the bank would be required to record this, as well as asking for identification of that person walking in off the street.

In your estimation, is this a possible deterrent to money laundering?

Mr. Friedberg. Anything that makes it more difficult to launder money is a deterrent, sir. I don't think it would stop it. I certainly think it would slow it down. Looking at the commission structure that the banker is willing to pay the launderer, if you are doing it in $3,000 increments or $4,000 to $5,000, they are looking for a day's pay. That's really what the Smurf is looking for. He is just going to have to call on more banks or get up a little earlier in the morning.

I don't know if it will stop it. Anything to deter it, to slow them down, will help.

Mr. Torres. Thank you. One other question. Perhaps Mr. Bandstra could answer this. You mentioned a number of banks in Miami doing business. What was the bank you indicated? You mentioned Pan American where you had your own account.

Mr. Friedberg. Yes, sir.

Mr. Torres. Is Capital Bank one of those?

Mr. Friedberg. Capital Bank is one where I had an account; yes, sir.

Mr. Torres. You laundered money through Capital Bank?

Mr. Friedberg. Yes, sir.

Mr. Torres. Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman St Germain. I would direct this to either Mr. Friedberg or Mr. Bandstra. Was Mr. Behar laundering only the money that was coming into him from Alex, his contact in Colombia, or was he handling an overage from other operators similar to him?

Mr. Friedberg. Mr. Behar had made additional contacts and yes, he was handling quite a bit of overage. He had developed a good reputation and a good organization. His reputation had opened up some other doors to him.

Chairman St Germain. Would you have been the first man who began laundering for him or did he have others before you?

Mr. Friedberg. Mr. Behar was doing it, I think, at least a year prior to my joining him.

Chairman St Germain. Would he do it himself?

Mr. Friedberg. Himself, a partner and his wife.

Chairman St Germain. Who was the partner?

Mr. Friedberg. Mr. Yuribi.

Chairman St Germain. He is the fellow who went to California?

Mr. Friedberg. That's correct.

Chairman St Germain. What was his ethnic background?

Mr. Friedberg. He's Cuban.

Chairman St Germain. Mr. Wylie.

Mr. Wylie. Thank you, Mr. Chairman. I think this has been some of the most fascinating testimony I have heard since I have been on this committee. I want to thank you. You have certainly dramatized the problem that we face. Mr. Bandstra, I think your testimony has been most helpful and valuable, too.

It looks like we have the responsibility of trying to come up with some answers to this problem.

I have no questions, Mr. Chairman.

Chairman St Germain. Mr. Parris.

Mr. Parris. Mr. Chairman, I just want to make sure that the record indicates that I did not mean in any way to suggest that the committee should not offset the expenses of Mr. Friedberg.

Chairman St Germain. I understand that.

Mr. Parris. I certainly support your position, Mr. Chairman.

Mr. Friedberg. On behalf of my family, thank you, sir.

Mr. Parris. I would just like to offer Mr. Friedberg a job. It is hard to find an honest man these days.

Mr. Friedberg. I will accept.

Mr. Parris. Do you have some money you want laundered? I have some shirts.

Mr. Friedberg. We have one institution that I think you will enjoy this, where I can walk in with $50,000 in cash and buy 50,000 dollars' worth of money orders and never worry about a currency transaction report being made. That is the U.S. Post Office. You might want to sit on that for a while. Mrs. Behar made it a practice to buy all her money orders at the Post Office.

Chairman St Germain. My staff informs me that this is not covered under the Bank Secrecy Act. Is that right, Mr. Bandstra?

Mr. Bandstra. That is right, Mr. Chairman. It is not.

Chairman St Germain. I have spent a lot of time sitting in this chair, Mr. Bandstra. With all due deference, the last thing I would want to be is a judge.

Mr. Bandstra. I am sorry. It is force of habit.

Mr. Chairman, if I might make one comment to the committee. In addition to stating perhaps the obvious, and that is that Mr. Friedberg's cooperation has been invaluable to the United States and the convictions that have resulted would not have been possible without his cooperation and without his working as a confidential informant for the United States.

The other comment that I wish to make, no one asked me what I would like to do about money laundering, and perhaps it is improper to state——

Chairman St Germain. Consider yourself asked.

Mr. Bandstra. In listening to the comments of Mr. Pickle, I believe that the first two items that he listed and discussed with the committee this morning would be very helpful in correcting a situation under title 31 as it now exists. We as prosecutors with the U.S. Attorney's Office are experiencing various difficulties in various parts of the United States with title 31, two of which I think will be corrected with the——

Chairman St Germain. Be a little more specific. I want it in the record. Why don't you elaborate for us?

Mr. Bandstra. All right. Perhaps I can answer it in the form—take the approach of answering a question asked by Mr. Annunzio when he asked Mr. Friedberg, when you went in and purchased a check for $9,000, that wasn't illegal, was it? Mr. Friedberg said, no. He said, if you were to go in and purchase 50,000 dollars' worth of checks, that wouldn't be illegal either, would it? Mr. Friedberg said, no. The answer to that question varies. The legality of doing that particular kind of behavior varies according to where a person is doing that in the United States.

Chairman St Germain. Because of different decisions by the appellate courts?

Mr. **Bandstra**. Yes.

Chairman **St Germain**. This is the aggregation we are talking about.

Mr. **Bandstra**. It is the aggregation. Of course, it is the aggregation on a particular day. There is no requirement or the requirement to file a currency transaction report has to be on a single day, at a single financial institution.

There is a division in the circuits right now. One of the problems relates to whether an individual can cause a financial institution to violate the Bank Secrecy Act by failing to file a currency transaction report. In the southern district of Florida, an individual can still cause a bank to violate that particular statute. In California, in the Federal district, of which California is a part, and also in New York, an individual cannot any longer cause a bank to fail to file.

Chairman **St Germain**. Would you explain what you mean by that?

Mr. **Bandstra**. Of course, it is a matter of judicial interpretation, but various cases involving these kinds of Smurfing activities have been filed, of course, throughout the United States, and it is the seventh and the ninth judicial circuits that have now expressed judicial opinions which say that an individual can structure his financial transactions in any way that he wants to and that his intent in structuring his financial transactions is not important; so therefore, an individual in the second and ninth judicial circuits can go now today to banks in New York and banks in California and purchase as many cashiers checks or money orders in whatever amounts he wants to and for whatever purpose he has without violating.

Chairman **St Germain**. As long as he doesn't or she doesn't purchase one with cash in the amount of $10,000 or more; is that correct?

Mr. **Bandstra**. No, Mr. Chairman, that is not correct.

Chairman **St Germain**. That is what I want you to explain so that everybody understands.

Mr. **Bandstra**. All right. To make it very simple, I could go into a bank in certain areas of the United States and ask to purchase three cashiers checks, and let's say I go in at three different times during the day and ask to purchase a check for $9,000 on each time, so that I am purchasing cashiers checks in the total amount of $27,000 in 1 day at a particular bank. Under those circumstances, of course, if a bank knew that I was doing this, it would be required to aggregate and to file a currency transaction report.

If I were to go in or cause Mr. Friedberg to go into that bank in order to disguise myself or to have three different persons actually conduct this transaction, in those particular areas it is no longer considered a violation of title 31.

Perhaps to state it more simply, and what I said before, an individual cannot cause a bank to fail to file a currency transaction report in various locations in the United States, and of course, the interpretations and the reasons for that get lengthy and perhaps are even a little bit beyond what I can say just off the top of my head here at this time.

Chairman **St Germain**. What I think you just said was that in those jurisdictions where they don't buy aggregation, they don't think aggregation is a violation or that it has to be reported. But the example you just gave was that Mr. Friedberg went in with $9,000, and Mr. Parris went in with $9,000, all $27,000 of which belonged to you. Is that your example?

Mr. **Bandstra**. That is right.

Chairman **St Germain**. In that instance I would agree with you, I can't fault the bank there. How would the bank know? It is three different individuals coming in. Are you telling me that there is a jurisdiction that has held that if three individuals come in on any a given day with $9,000 and purchase three money orders for $9,000, that—how can they aggregate?

Mr. **Bandstra**. I think I can simplify my example a little bit.

Chairman **St Germain**. Yes, please.

Mr. **Bandstra**. Perhaps to use three individuals only confuses things. If I were to use three different branches of a particular bank, I think it would make it a little bit more simple. If I as an individual, just myself, would take $27,000 and go to three branches of the same bank and purchase a $9,000 cashiers check in each of those three branches on a particular day in the southern district of Florida, and my intent is to cause that bank to fail to file a currency transaction report, that is against the law in Miami, FL, and in the southern district of Florida.

Chairman **St Germain**. Because of the court decision.

Mr. **Bandstra**. Yes; because of the court decision.

Chairman **St Germain**. But it would not be against the law in New York or California.

Mr. **Bandstra**. Yes; it would not be. And part of the problem there is because the courts have said that an individual cannot cause a bank to fail to file a CTR. From what I understand from what Mr. Pickle addressed to the committee here this morning, that this would be a part of his legislation, that an individual can cause a bank to fail to file a currency transaction report. In my opinion, that would clarify some of the problem. That would assist us as prosecutors and make a more uniform enforcement of title 31.

The second thing is, of course, the forfeiture provision. I am presently dealing with cases in the southern district of Florida in which there is a great deal of money seized and a great deal of money laundered, but simply by having that money seized as a result of money laundering does not make it forfeitable.

In fact, in one particular case that is now pending, a great deal of money, in order to make that money forfeitable, we have to prove that there is a drug connection with that money.

Chairman **St Germain**. Let me ask you this question. Mr. Behar is—that's his name?

Mr. **Bandstra**. Yes, Mr. Behar.

Chairman **St Germain**. Did you seize any of his funds?

Mr. **Bandstra**. Some money was seized from Mr. Behar. I don't know the exact amount, and it wasn't a great deal.

Chairman **St Germain**. It was not a great deal.

Mr. **Bandstra**. No; it was not.

Chairman **St Germain**. So he lived high off the hog for a long period of time, made a lot of money, and yes, he is going to prison, but, when he gets out, he has a pension fund.

Mr. **Bandstra**. He has retained whatever it is other than what was seized on the spot. He retains that money, yes.

Chairman **St Germain**. Let me ask you this. How much money did you make, Mr. Friedberg, that you had to return?

Mr. **Friedberg**. Some weeks it was $4,000 or $5,000 a week.

Chairman **St Germain**. During that period of time that you worked for Mr. Behar, what was the total amount that you made?

Mr. **Friedberg**. $30,000, $35,000, $40,000.

Chairman **St Germain**. And he had how many other Smurfers working?

Mr. **Friedberg**. A half-dozen. For every dollar I earned, Mr. Behar earned $3.

Chairman **St Germain**. He earned $3. Let's use the $30,000. That's $180,000 times 3. That's $540,000 he made, right?

Mr. **Friedberg**. Roughly.

Chairman **St Germain**. Yes, roughly. And of that, how much was seized, Mr. Bandstra? Let's use that as a ballpark.

Mr. **Bandstra**. Mr. Chairman, I'm sorry, I don't know the amount of money that was seized from Mr. Behar. I believe it was less than $100,000.

Chairman **St Germain**. I bet we are being conservative here with this quick figuring, so he probably has over $1 million salted away for when he gets out after probation and all that. He pled guilty to what, three counts?

Mr. **Bandstra**. He pled guilty to two counts in four separate indictments, and he received a sentence of 3 years.

Chairman **St Germain**. A total of how many years?

Mr. **Bandstra**. Three years.

Chairman **St Germain**. Three years? For all of them?

Mr. **Bandstra**. For all of them. I might say, Mr. Chairman, that he was sentenced at four different times by four separate courts and that the sentences were made to run concurrent in each case.

Chairman **St Germain**. And as a result thereof, did he help you get to anybody above him?

Mr. **Bandstra**. As part of his plea agreement with the United States, he has agreed to cooperate, he has cooperated, and he is expected to testify in an upcoming case, yes, sir.

Chairman **St Germain**. Mr. Friedberg, you must feel pretty silly. I mean the other fellow, who really put the tag on this operation, your Mr. Behar, is in for 3 years and will probably get time off for good behavior—right, Mr. Bandstra?

Mr. **Bandstra**. If he follows the course of most Federal prisoners, yes.

Chairman **St Germain**. So how long will he be in, approximately? Could he get off in 18 months, 2 years?

Mr. **Bandstra**. I am not familiar enough with his guidelines, but I would guess it would be between 1 to 2 years.

Chairman **St Germain**. Between 1 and 2 years. So he goes to a hotel where we will pay his room and board for a year and a half, and he has made $1 million. Don't you feel silly, Mr. Friedberg? You had to sell your house, you had to sell your condo, and you are spending your savings, and you are the fellow who helped us out, the taxpayers and the Justice Department.

Mr. **Friedberg**. That is my subject for the next subcommittee.

Mr. **Wylie**. Mr. Chairman.

Chairman **St Germain**. Yes, Mr. Wylie.

Mr. **Wylie**. Would you yield, please?

Mr. Behar was charged with four different crimes, you said, in four different courts?

Mr. **Bandstra**. He was charged in four different indictments, basically with the same crimes in each indictment.

Mr. **Wylie**. What were those crimes, again?

Mr. **Bandstra**. The first was a conspiracy. It was actually a violation of title 18-371, which is a conspiracy to defraud the United States by the scheme that we are here talking about today. The second count that he was charged with in each of these indictments was the violation of title 18, section 1001, which is the scheme itself. It is a conspiracy to defraud the United States and then a scheme to defraud the United States.

Mr. **Wylie**. Should we make it a separate crime to launder money?

Mr. **Bandstra**. Mr. Wylie, that would be my recommendation, but I recognize the difficulty with that. If we could identify what money laundering is, if we could say it is illegal to do whatever it is that money laundering is, that would be, in my opinion, the best thing to do. I recognize, however, that to define it and to identify it and to prove it is very, very difficult.

Mr. **Wylie**. Thank you.

Chairman **St Germain**. Mr. Bandstra, what was the maximum sentence that Mr. Behar could have received?

Mr. **Bandstra**. In each of the indictments to which he pled guilty to two counts, he was exposed to, with no recommendation by the U.S. Government in any way, he was exposed to a 10-year maximum penalty.

Chairman **St Germain**. So it could have been 30 years rather than 3?

Mr. **Bandstra**. It could have been 10 years. Well, it could have been 10 years in each case.

Chairman **St Germain**. If they didn't run concurrent.

Mr. **Bandstra**. It could have been 10 years in each case or a total of 40 years, yes.

Chairman **St Germain**. A total of 40 years.

Mr. **Bandstra**. Yes, sir.

Chairman **St Germain**. I will make this last observation because we have another witness and we want to have him up here, but the President's Commission on Organized Crime and the administration have sent us a very tough bill. Other Members are introducing legislation. But here we look at a situation where a man has probably salted away in excess of $1 million, was exposed to 40 years and he gets 3 years, which will probably go down to a year and a half. What in God's name? We are not even really punishing people for money laundering with the so-called weak laws we have. We are letting them off very, very easily.

Should we really spin our wheels if the courts are going to be this understanding of the Behars of this world? Isn't it frustrating for you, Mr. Bandstra? You work so hard.

Mr. **Bandstra**. Mr. Chairman, I don't mean to speak out of place so I'm not going to comment upon the sentences of the Federal Judiciary in the southern district of Florida.

Chairman **St Germain**. I'm not practicing law.

Mr. **Bandstra**. I will add, however, that there were two penalties imposed on Mr. Behar. One, of course, is the IRS assessment that he presently is still facing, and the second that he did have to pay a defense attorney and deal with a defense attorney. Or he had these problems, of course, in court, and so he did have to go through that, but it is the sentence that he had, the 3 years.

Chairman **St Germain**. The defense attorney did very well for him.

Mr. **Bandstra**. Yes; I believe he did.

Chairman **St Germain**. Sure. He probably did—of course, you wouldn't know what the fee was; would you?

Mr. **Bandstra**. No; I don't.

Chairman **St Germain**. He probably did all right, too.

Mr. Friedberg, again many thanks. Mr. Bandstra, many thanks to you. I realize that U.S. attorneys are not too well compensated, so we are grateful to you, for the time and the work and the devotion you put into this.

Mr. **Bandstra**. Thank you, Mr. Chairman. We appreciate the opportunity to be here today, and I will be responding to you, sir, with the questions that you have asked me.

Chairman **St Germain**. Thank you.

We will now have our next witness, who has been waiting very patiently. He has some very delightful information for us, and I am going to try to pronounce this right. Mr. Richard Wassenaar.

He is the Assistant Commissioner for Criminal Investigation at IRS, Internal Revenue Service. Would you pronounce your name for me, please?

Mr. **Wassenaar**. Pardon me?

Chairman **St Germain**. How do you pronounce your name?

Mr. **Wassenaar**. Last name?

Chairman **St Germain**. Yes.

Mr. **Wassenaar**. Wassenaar.

Chairman **St Germain**. OK. We will place, naturally, your entire statement in the record. We are putting up the charts, and you may proceed.

STATEMENT OF RICHARD C. WASSENAAR, ASSISTANT COMMISSIONER FOR CRIMINAL INVESTIGATION, INTERNAL REVENUE SERVICE (IRA)

Mr. **Wassenaar**. Thank you, Mr. Chairman, and Members of the subcommittee. We certainly appreciate the opportunity that you have given to us, to relate to you the role that the Criminal Investigation Division of the Internal Revenue Service plays in not only attacking traditional money laundering situations but also in attacking other types of fiscal fraud wherein financial institutions, both domestic and foreign, play a role—a role that is played by the financial institutions in many cases, wittingly or unwittingly.

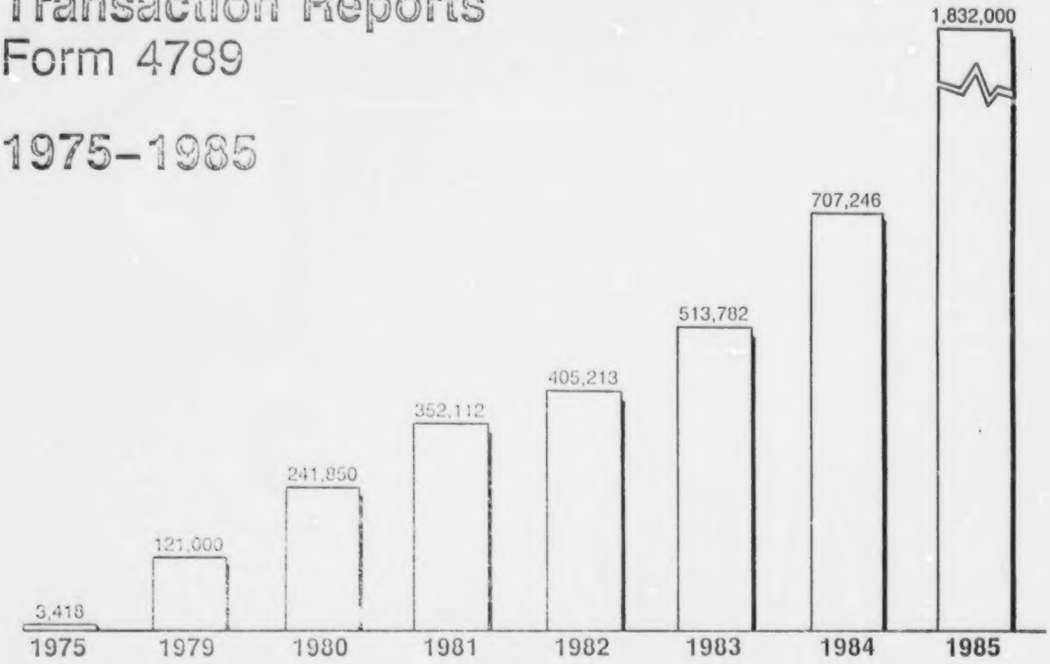
The key tool that is used by the Internal Revenue Service in attacking money laundering cases, of course, is the Bank Secrecy Act. Since the subcommittee is very familiar with the aspects of the act, I will not attempt to summarize title 31 of the Bank Secrecy Act, other than to comment that the principal part of title 31 of the Bank Secrecy Act that we use is the current requirement that all currency transactions in excess of $10,000 be filed with the Internal Revenue Service.

As the chart on the left reflects, back in 1975, only 11 years ago, the Internal Revenue Service only received approximately 3,400 currency transaction reports [CTR's]. Since that time there has been a gradual increase through 1984. The increase from 1983 to 1984 was approximately 50 percent. But the most substantial increase, of course, has been in the year 1985, a whopping 120 percent increase.

[The chart referred to follows:]

Total Currency Transaction Reports Form 4789

1975–1985



Chairman **St Germain**. What is the jagged line?

Mr. **Wassenaar**. Well, the total amount there is $1,832,000. I did not have poster board that could go up high enough to accurately reflect that, in relation to the other lines. So I put a jagged line there.

Chairman **St Germain**. Excuse me. That being the case, it should be more than twice as high as the 1984 number; right?

Mr. **Wassenaar**. Absolutely. And my poster board did not go that high.

Chairman **St Germain**. Was there a period of time in 1985 when the increase became more dramatic?

Mr. **Wassenaar**. That is a very interesting point.

Chairman **St Germain**. I thought it might be.

Mr. **Wassenaar**. In the first month of 1985, we were receiving an average of about 60,000–65,000 CTR's a month, which was about average for the entire year 1984. The latter part of February 1985, the Bank of Boston was indicted and pleaded guilty and there, of course, was a lot of publicity relating to that situation. And I think a few months later this subcommittee held a hearing relative to that same matter and that also caused additional publicity.

But within 4 or 5 months after the *Bank of Boston* case occurred, we saw the volume of CTR's increase from an average of 60,000 a month up to a current amount of 250,000 a month. So we are talking about at least a fourfold increase in the volume and numbers of CTR's that are being filed by financial institutions on a monthly basis.

Current projections are——

Chairman **St Germain**. Excuse me, but would you agree that the fact that Mr. Stanke's suspicions were aroused and he started looking a little more at that Federal Reserve district in Boston, and the fact that there were public hearings with substantial coverage, helped to arouse the awareness or to motivate financial institutions to be more cautious or more attentive to reporting the CTR report, the cash transaction report?

Mr. **Wassenaar**. I think there is no doubt about it. I think it started primarily with the Bank of Boston publicity itself, followed up by a number of subsequent disclosures to the Treasury of self-admitted violations on the part of institutions. I think the subcommittee's hearing, later on that same year, also brought additional publicity relative to this matter.

All of this, certainly, helped.

Shortly after the *Bank of Boston* case occurred, Treasury was approached by the American Banking Association for assistance, for example, in helping to educate financial institutions in terms of the currency transaction reports that were to be filed. And I think Treasury as well as the Department of Justice participated in a substantial training effort with the American Banking association to help educate the American banking community.

That, too, caused an increase in the number of CTR's filed.

The problem, however, of generating so much activity, is that currently the currency transaction reports are filed in the IRS Detroit Data Center and last year, at this point in time, they were geared up to process about 60,000 or 70,000 currency transaction reports every month. And now——

Chairman **St Germain**. Were you really geared up or were you straining?

Mr. **Wassenaar**. No, we were geared up——

Chairman **St Germain**. You had no problem processing those?

Mr. **Wassenaar**. We had no problem processing CTR's at a volume of 60,000 to 70,000 a month. But in a 12-month period of time we saw the volume increase fourfold, and now we are receiving an average of about 250,000 a month. Of course, it has created somewhat of a backlog.

We are getting on top of that backlog, and we have every reason to believe that in the next few weeks we will be current. It is our goal to process into the computer system, into the Treasury Enforcement Communication System [TECS], which houses all of this information, currency transaction reports within 30 days after receipt.

Chairman **St Germain**. Let me ask you this, do you have to upgrade your computer? I do not know much about computers.

Mr. **Wassenaar**. Yes; we absolutely did. The computer we had was certainly not capable of handling the capacity that we are currently experiencing.

Chairman **St Germain**. How about personnel?

Mr. **Wassenaar**. Yes; we have had a very substantial increase in personnel.

Chairman **St Germain**. From what number to what number, approximately?

Mr. **Wassenaar**. Last year, at this time, we had approximately 50 individuals at the Detroit Data Center involved in the processing of the CTR's. Today we have approximately 250.

Chairman **St Germain**. Now when you say processing—you know, it is all well to say processing—but are they also looking at these to determine whether they should go into the next phase, or the investigatory phase?

Mr. **Wassenaar**. Well, most of the screening is done once it is put into the computer. Once the information is put into the computer, that is when you can have the computer help analyze and provide certain printouts in a more meaningful form.

However, when the CTR forms are first received in the data center, all of them have to be numbered so that we have adequate control over the form—not only in terms of control during the processing of the form, but also in terms of subsequently retrieving that form should it be necessary for evidentiary purposes.

There is a fairly elaborate coding and editing process, a process that is necessary before it is put into the computer. We also have people who screen the forms to determine that they are accurate. Does the form contain all of the information that is required? And if not, then that individual has to either return the currency transaction report to the bank or make a phone call to the bank to have the additional information provided.

So it is a fairly involved process, but this year we anticipate receiving approximately 3 million CTR's, which again will be almost a 100-percent increase over last year.

One of the perhaps popular misconceptions, when we talk about the subject of money laundering, is that we think that virtually all money laundering involves narcotics trafficking. And while I would submit that perhaps the greatest percent of money laundering cases involves narcotics trafficking, the chart on my right reflects that not all of them do. This chart shows the total number of money laundering investigations we have had in each of the last 5 years. The number on top of each of those columns reflects the total number of investigations initiated in that year, and the orange-shaded portion of each of those columns reflects those money laundering investigations where we have been able to establish a narcotics connection.

[The chart referred to follows:]

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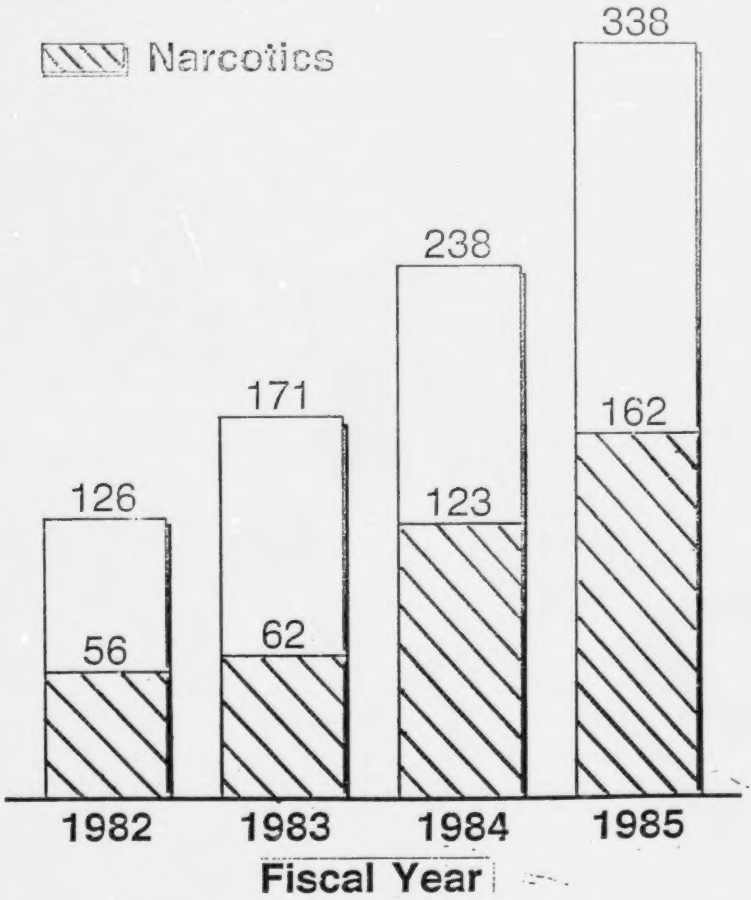
Title 31 Investigations



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For example, in 1985 we initiated a total of 338 money laundering investigations. We were only able to establish that the proceeds were connected to narcotics in 162 cases. Now the difference could well be——

Chairman St Germain. Approximately 50 percent.

Mr. Wassenaar. About 50 percent in each of the last 4 years. The difference, however, could be that many of those involve narcotics proceeds. It is just that we were not able to prove, in the course of that investigation, that it came from that particular source.

I submit that some of the difference might also be accounted for by normal tax evasion attempts on the part of individuals, like skimmed receipts from restaurants and organized crime money that does not necessarily deal with narcotics but could be from some other illegal source.

The bill that Congressman Pickle talked about this morning I think would be of help to us in this respect, in that looking at the cases we worked last year we were able to establish 162 cases tied into narcotics. Seizure and forfeiture is relatively no problem in those cases because once we are able to establish a narcotics connection and prove that the income came from an illegal source, we are able to seize it.

But in many of the remaining 180 cases, where we were not able to tie it in to narcotics, although we were able to prosecute the individuals involved in the money laundering, we were not able to seize or seek forfeiture of the money that was being laundered.

Since 1981, we have completed 873 money laundering cases. At the present time, we have in our inventory or under active investigation, over 300 money laundering investigations. Included in that 300 number are over 60 financial institutions that are currently under investigation. I use the term "financial institutions" in the fairly broad sense. I do not mean to imply that the 60 financial institutions is limited to banks. Indeed, it is not. It includes savings and loans. It includes credit unions. It includes brokerage houses, et cetera.

Last year we recommended criminal prosecution in 317 cases. Since 1981, the Internal Revenue Service has been successful, along with the Department of Justice, in convicting some 31 financial institutions. Eight of those were last year alone.

In response to a question that was asked earlier this morning, or a concern that was expressed, since 1984, we have also prosecuted 34 officers and employees of financial institutions.

With your permission, I would like to talk about a couple of cases. I have another poster that we can put up that I think will graphically depict the flow of funds in this particular case.

[The poster referred to during this part of the testimony was presented during the hearing to illustrate money laundering activities and is not available as a page-sized document.]

This case involved an individual in Florida by the name of Botero. In the course of 8 months, Mr. Botero laundered some $57 million through a branch of the Fort Lauderdale Bank. In this particular case, Smurfing was not involved. He didn't need the Smurfs. He had the cooperation of three bank officers. Each of the bank officers received as their share, a commission ranging from one-half to 1 percent.

One of the interesting aspects about this case is that Mr. Botero was a prominent Colombian businessman, the first Colombian national ordered extradited to the United States by the Supreme Court of Colombia. He was convicted last year, in 1985, and is currently under a 30-year sentence in prison.

If I could spend a minute trying to interpret this fairly large poster, the black dot at the very top of the poster reflects that $56 million was directly deposited into the Landmark Bank, into the accounts of false El Salvador individuals. He had five accounts at this bank.

Chairman **St Germain**. Nonexisting individuals?

Mr. **Wassenaar**. Nonexisting individuals. With the cooperation of these three bank officers, of course, Mr. Botero would bring large amounts of currency into the bank on a regular basis, and all of the currency was deposited into one of those five accounts. Most of that money or $38 million, was subsequently transferred to another bank in Florida, to the correspondent accounts at the Pan American Bank. Correspondent accounts for the Banco de Bogota and the other three Colombian banks listed.

Once the money was on deposit in those correspondent accounts, of course it could then be wire transferred to the parent bank in Colombia; $38 million was remitted to Colombian banks in that manner in a period of 8 months.

The $38 million in that particular case, as we were able to discover after we had completed our investigation, was primarily to pay source suppliers of narcotics, just to pay for the wholesale cost of the narcotics being shipped to this country.

If one can accept the fact that the average markup on wholesale narcotics is roughly nine times wholesale value, then we are talking about a very substantial amount of narcotics' dollars that were paid for with 38 million dollars' worth of wholesale of narcotics. We are talking about 10 times the $38 million, whatever that figure comes to.

Chairman **St Germain**. $380 million.

Mr. **Wassenaar**. Close to half a billion dollars in street value of narcotics was laundered, and the proceeds were laundered through this Landmark Bank.

Chairman **St Germain**. Excuse me. It says Botero, $56,692,000. Are you telling me he deposited all of that into the Landmark Bank? Where did he put the rest of that money?

Mr. **Wassenaar**. What he did with his profits or the excess, the retail price, is really unknown. It wasn't until after we had finished this investigation that we were able to tie this into narcotics, which really prevented us, even though we knew there was a substantial money laundering operation here, from seizing and seeking forfeiture on the money that was going through this illicit conduit.

There again, I think Mr. Pickle's bill that he talked about this morning would be of some aid in that respect, and we would not have permitted the full $38 million to go over to Colombia to pay for the narcotics that were being purchased.

The next case---

Chairman **St Germain**. Excuse me. Would you finish the chart for us? We covered Pan American and the $38 million that went to Colombia. Explain the rest of that chart to us, please.

Mr. **Wassenaar**. That is where most of the money went. Of course, that is the money that was of greatest concern to us.

Chairman **St Germain**. Below there, you have checks.

Mr. **Wassenaar**. We had $10 million in other distributions, consisting of 20 wire transfers and 132 cashier's checks. Those were deposited or transferred to accounts over which Botero had no direct control. The exact purpose of each of those transfers is really uncertain to us.

Chairman **St Germain**. The "blue."

Mr. **Wassenaar**. The amounts on the right, those were domestic transfers, to accounts that were under the control of Mr. Botero himself. He controlled all of the accounts on the right and he also controlled all of the accounts on the left.

It is very possible that the other distributions, going down, the $10 million in distributions, could have been to Smurfs, to other individuals assisting him in his business.

Chairman **St Germain**. You said there were people within the institution that cooperated, commission checks to bank officials for nonfiling of CTR's.

Mr. **Wassenaar**. Right.

Chairman **St Germain**. You don't know what that amount was?

Mr. **Wassenaar**. The officers in this particular bank were receiving a fee ranging from one-half to 1 percent of the currency they were taking in. In the course of 8 months, they took in $56 million. The amount they received was therefore very sizeable.

Chairman **St Germain**. You initially said it didn't involve Smurfs, but indeed, it did. He was the Smurf, but he had the cooperation of bank officials. Isn't that the case? He brought the cash in and the CTR's were not filed.

Mr. **Wassenaar**. Right. Traditionally, we think of the term "Smurf" as the individual who scurries about from bank to bank, converting $9,000.

Chairman **St Germain**. We will refer to Botero here as the super-Smurf.

Mr. **Wassenaar**. Right; indeed, he was. It is very possible above him, in the organization, there could have been some type of Smurfing activity.

Another case I would like to bring to your attention is a case again where we had the complicity of bank officers. This was a case that took place in California. It involved the Garfield Bank. It also involved an attorney by the name of Nathan Markowitz. Nathan Markowitz had been a fairly prominent attorney within the L.A. area, who for all practical purposes, had given up the practice of law because he could make more money by laundering money.

Nathan Markowitz had made an arrangement with the president of the Garfield Bank to assist him in laundering money. Nathan Markowitz had a lot of contacts with individuals involved in narcotics. He would receive whatever currency they would bring to him. He would bring it into the Garfield Bank, assuring the narcotics trafficker that no CTR was filed with the Internal Revenue Service. Markowitz, being an attorney, would create foreign corporations for these narcotics traffickers. Once the currency was brought into the Garfield Bank without a CTR report being filed, the Garfield Bank could wire transfer that money to the same country where the foreign corporation was created. The money is immediately offshore. That money could then come back to the narcotics trafficker under the guise of a loan from a foreign corporation.

It is, at a minimum very difficult for the Internal Revenue Service to charge an individual with receiving income when he has loan documents from some foreign corporation, and that is his primary means of buying his house or his Mercedes.

Chairman **St Germain**. Could you describe the wire transfers from Garfield Bank to foreign bank X. How was that accomplished?

Mr. **Wassenaar**. The same thing really happened in the *Botero* case. Once the money is in the financial institution——

Chairman **St Germain**. Let's use Garfield Bank.

Mr. **Wassenaar**. The money was delivered by the narcotics trafficker directly to Mr. Markowitz. He or one of his associates would then physically transport that money to the Garfield Bank. Once it was on deposit at the Garfield Bank, in the accounts of nominee names, whatever, then that money, the balance in that account or any part of that account, could be wire transferred to virtually any financial institution.

Chairman **St Germain**. They can't put the money in a wire. When I was a kid at Woolworth's and some of the shoe stores, you could go downstairs and buy your shoes, and then they would put your money in this little cup that was on a wire and it went upstairs to the office and down came the change and the receipt. That money, those $20, $50, $100 bills can't go through the wire to foreign bank X; right?

Mr. **Wassenaar**. That's correct.

Chairman **St Germain**. Describe to us how that happens. How does the money get from Garfield Bank to foreign bank X?

Mr. **Wassenaar**. It is just a matter of crediting and debiting, by way of electronic transfer of funds.

Chairman **St Germain**. Garfield Bank doesn't sound to me like the type of institution that would ordinarily be dealing with foreign banks. It sounds like a smaller bank.

Mr. **Wassenaar**. That's true.

Chairman **St Germain**. They don't have credits and debits back and forth.

Mr. **Wassenaar**. Right.

Chairman **St Germain**. Tell us how that money arrived at the foreign bank.

Mr. **Wassenaar**. I assume that money would then go to the Federal Reserve in that particular district. That Federal Reserve district would give proper credit to the bank that really should be holding that particular amount of currency.

Chairman **St Germain**. The foreign bank?

Mr. **Wassenaar**. Right.

Chairman **St Germain**. What I am trying to determine is, is it possible to monitor wire transfers in excess of $10,000 or $20,000?

Mr. **Wassenaar**. I strongly suspect that most wire transfers are in excess of $10,000 or $20,000. I also believe that the volume involved in wire transfers on any given day is probably bigger than any IRS computer can currently handle.

Chairman **St Germain**. Are you saying there is no way to have a handle on wire transfers?

Mr. **Wassenaar**. I think there is. I think in terms of the amount of wire transfers on any given day, I heard at one time it was roughly $2 billion. I have to assume that most of that is for very legitimate purposes.

Within the past year, Treasury has issued new regulations which will now enable us to have financial institutions provide to us records relating to their wire transfer activity over a given period, which I think will be very helpful. That way, we will not force all financial institutions to provide wire transfer information to us, but we may be in a position to ask suspicious entities to provide wire transfer information to us.

I think that regulation, which just went into effect in the past few months, will indeed be very helpful to us.

Chairman **St Germain**. Do you know how big Pan American Bank is?

Mr. **Wassenaar**. No. I'm sorry. I don't know the assets of that bank. I did hear Mr. Friedberg mention this morning that he was using Pan American Bank.

Chairman **St Germain**. Yes, that he utilized as his personal bank. If that is the case, how did you catch up with Botero? What brought him to your attention?

Mr. **Wassenaar**. I'm not certain how we got started, with several hundred investigations going on at any given point in time.

Chairman **St Germain**. Could you submit for the record information as to how you came upon the Botero situation?

Mr. **Wassenaar**. Yes. I will also add to that the source in the *Markowitz* case.

[Information to be furnished follows:]

Source of Botero Case

The *Botero* case was referred to the IRS by the FBI, which was conducting an embezzlement case and found a number of unfiled CTRs. The *Markowitz* case was initiated on the basis of information received from a confidential source. As a result of this information, we placed an undercover agent in the Markowitz organization.

Mr. **Wassenaar**. I will submit that in the *Markowitz* case, we were able to bring that case to a successful conclusion primarily because one of our agents posed as a narcotics trafficker who had lots of money which he wanted Mr. Markowitz to launder. Indeed, he did launder a substantial amount of our undercover agent's money. With that operation, we were able to gather not only the evidence on Mr. Markowitz himself, but on the three bank officers who were associated with the Garfield Bank, and two of Mr. Markowitz' associates.

In that particular case, we convicted the three bank officers. We convicted the three associates of Mr. Markowitz. Shortly after Mr. Markowitz' indictment, he was assassinated in the parking lot in Los Angeles. Also in that case, the Garfield Bank was fined a total of $309,000, which was equivalent to their entire income for the year 1980.

Chairman St Germain. Do you know how much money the bank tellers were paid?

Mr. Wassenaar. Yes, they were extracting a somewhat higher fee than the bankers in the *Botero* case were provided.

I would now, with your permission, like to show you some slides that were taken during an actual money laundering investigation or investigations. The first five slides involve a case that we call the Sonal case, where roughly $200 million was laundered by the Sonal organization over a period of 15 months in Florida.

Sonal was primarily a currency exchange type of an operation. The proprietors of this business had arrangements with the bank to receive up to $1 million a day that could be deposited in the bank account. And as a result, they had a lot of narcotics traffickers bring in their currency to the Sonal organization.

Chairman St Germain. What type of business was it?

Mr. Wassenaar. Currency exchange.

This is a picture of two individuals removing from their trunk cardboard boxes full of currency, about to be delivered to this Sonal organization.

Chairman St Germain. Excuse me, delivered to the Sonal? That looked like a financial institution that they were parked in front of.

Mr. Wassenaar. Well, in this particular case, the Sonal Co. had an office right within a bank.

Chairman St Germain. What bank was that?

Mr. Wassenaar. I do not have the name of the bank but I could——

Chairman St Germain. Could we flip back to the first slide? No, the other way.

Isn't that the Chasenhook Federal something? Is that Chasenhook?

Mr. Wassenaar. No, this was in Florida.

Chairman St Germain. Do you have some worthy assistant here who might help you with that question?

Mr. Wassenaar. Yes, he said it was the Capital Bank.

Chairman St Germain. Capital Bank?

Mr. Wassenaar. They had an office right within the Capital Bank in Florida.

Chairman St Germain. The Capital Bank is spelled c-h-a-s?

Mr. Wassenaar. Well, this was in a parking lot. The Capital Bank, or at least the branch, was some doors down from this particular——

Chairman St Germain. Oh, they have a lot of banks in this parking lot?

Mr. Wassenaar. Yes, it must be similar to Wilshire Boulevard.

Chairman St Germain. Would you, for the record, submit the exact name of the bank, in case you might be mistaken?

Mr. Wassenaar. I certainly will.

Exact Name of the Bank in a Slide

The name of the bank that received the Sonal, Inc., deposits was the Capital Bank. The picture of a bank in the slide was next door to the Capital Bank building

But anyway, this is a picture of individuals removing cardboard boxes full of currency from their trunk and it is currently being delivered to the Sonal organization.

And this is a picture of what was contained in one of those cardboard boxes, bundles of 20's.

Now bear in mind, again, the Sonal organization could only deposit to its bank $1 million a day. That is all the bank was willing to take from this Sonal organization.

This is another package of a smaller amount of currency that was delivered to the Sonal organization.

And this is yet another means of delivering money to the Sonal organization, in just a brown paper bag. One of the significant aspects of this particular slide is that, if you look closely, on the bag itself is a red delta sign.

Chairman **St Germain**. What is in it?

Mr. **Wassenaar**. This same red delta sign subsequently showed up in another case where there was a substantial seizure of cocaine. And that cocaine contained that same label, or what we think is a trademark by whatever organization.

Now since Sonal could only deposit $1 million in currency into their bank, and oftentimes they would receive in excess of $1 million in a given day in their organization, they had—at any given time—a substantial surplus within their business. And so on the day that we decided, along with the Customs Service, to execute a search warrant on the Sonal business, we were fortunate to find that they had such a surplus on hand.

And this is a picture taken of the currency that was seized by Customs and the Internal Revenue Service on the Sonal organization. On the table in front of you is roughly $3.2 million in currency.

Chairman **St Germain**. He was running a handsome surplus.

Mr. **Wassenaar**. Indeed it was.

In addition to seizing the $3.2 million in currency, we also seized a cashier's check for approximately $4 million. So the one seizure, on 1 day, in this particular organization involved $7.2 million.

Chairman **St Germain**. Of course, you have returned that money; have you not?

Mr. **Wassenaar**. I hope we did not. I think in this particular case, because we were able to show that it indeed came from narcotics, the Government would prevail in a forfeiture case.

But again, if the Government were not able to prove that it came from narcotics, theoretically, we may have to return money of that nature. And that, again, I think is the real benefit of Congressman Pickle's bill.

Now we switch over to southern California. This case involved a heroin organization known as the Araujo family. In this picture, if you look real closely, you see two individuals carrying a large cardboard box into that Mexican-American National Bank, which is right across the border.

In this particular case, currency transaction reports were indeed filed by these financial institutions. And the banks involved in this particular case were not knowledgable of it—they were not involved in the criminal act.

The bad guys here were providing false or fictitious information to the bank which caused them to file a false currency transaction report.

Chairman **St Germain**. Could we go back to Sonal a minute? You said the bank was taking $1 million a day from Sonal. Was that because it was a money exchange operation?

Mr. **Wassenaar**. Right.

Chairman **St Germain**. Did Sonal have an exception? Were they on the exempt list for reporting?

Mr. **Wassenaar**. I am really not certain. I doubt if they were. I do not think that a currency exchange can be granted an exemption to the filing.

Chairman **St Germain**. Could you look that up and reply to that in writing?

Mr. **Wassenaar**. Sure.

STATUS OF SONAL, INC.

Sonal, Inc., was not on the exempt list at the Capital Bank.

Mr. **Wassenaar**. This particular case involved, again, a massive heroin distributing organization primarily throughout southern California and this was one of the means by which they were transporting the currency into a bank. But again, in this particular case, the bank did file a currency transaction report. However, it was a false report.

Next slide.

Here are some of the same individuals, who were involved in that case, physically removing from their automobile more currency. If you can focus that a little bit better, the individual that is removing the paper sack from near the driver's door, if you look real closely you can see the currency sticking out of the top of the bag. And of course, they are also removing——

Chairman **St Germain**. Things are tough, they could not afford the right size bag.

Mr. **Wassenaar**. That is right. There is also some currency in the trunk of the automobile. In the trunk of the automobile, you have small boxes and it looks like another bag full of currency.

When we decided to move in on this case, this was some of the currency that was seized in this particular case. While we were working this particular case, we were aware—from a very early point in time—that we, indeed, were working on a narcotics organization. The Araujo family was involved not only in the distribution of the narcotics itself, they were also involved in the laundering of the money.

The key here is that this whole investigation was started with a single CTR that we received. It was analyzed and we determined we do not have a taxpayer who files a return by this name. That little bit of suspicion led us on to this massive organization.

We also had enough time in this particular case to, in addition to charging them with money laundering, we also charged them with income tax evasion. We were able to show that in the 3 years that this organization was operating in southern California, they had received $27 million in income and filed no income tax return.

Mr. **Wylie**. This was a currency exchange operation, was it not? This was not a bank?

Mr. **Wassenaar.** No, these were individuals who were actually selling narcotics and laundering their own funds.

Mr. **Wylie.** Oh, they were using their own funds?

Mr. **Wassenaar.** Right. In this particular case, we obtained arrest warrants on, I think, 17 individuals and were successful in arresting 12 or 13. The rest fled to Mexico. We were able to seize, out of domestic banks, roughly $12 to $13 million in currency plus the income tax charge showing unreported income of some $27 million over a 3-year period of time, all started with a single CTR that was received by the Internal Revenue Service.

Thank God for the Bank Secrecy Act.

Going back to some charts or posters which perhaps will summarize the testimony we heard earlier this morning from Mr. Friedberg. The chart on the left shows the money obtained from narcotics trafficking, and then it is parceled out to the Smurfs. Those individuals up there are Smurfs. They then run, scurry about from bank to bank converting it into a pile of cashiers checks.

Cashiers checks then can be brought to any one of a number of different banks throughout the country because the deposits of cashiers checks do not generate a CTR form. So once this conversion is made from currency to cashiers checks, the cashiers checks are then deposited into a domestic bank account. No trail of a CTR. No CTR is filed whatsoever.

Of course, once the money is deposited into any one of these banks, like in San Francisco, Los Angeles, Denver, or Omaha, it can then be wire transferred down to Miami, and then from Miami it can be wire transferred to Panama, to Colombia, to Switzerland or a variety of different countries throughout the world.

I think we fairly well covered Smurfing this morning. This is to give, I guess, more of a graphic portrayal of how this Smurfing operation works.

One of the keys in most of these money laundering operations, however, is the use of a foreign bank, a foreign financial institution. You find a good part of the money eventually ending up in a foreign bank, in large part those financial institutions located in one of the tax haven countries, countries primarily in the Caribbean, Panama, Grand Caymans, Bahamas, et cetera.

Now, the use of tax havens, however, is not limited to just money launderers. What we are finding with an increase in activity is the use of foreign tax havens to also assist in the fraud generated by illegal tax shelters, and with your permission, I would like to spend just a little bit of time in that area.

At the present time, we have over 400 investigations in process involving illegal tax shelters. In over 50 percent of those investigations, we have tax shelters which have some connection, some transaction involving a tax haven bank—we think intentionally structured in that manner so that it makes it more difficult for us to get behind the true nature of the alleged transaction.

Let me give you an example. We currently have an investigation that, although it is current, I think I can make some reference to because there have been a number of public records brought on it as a result of search warrants executed some time ago. This tax shelter organization is called the USTPS, U.S. Tax Planning Service, headquartered primarily out of the Grand Caymans, structured primarily to accommodate doctors, physicians, people in the medical field. We think of all of it as fraud.

What USTPS would provide to an interested customer or client was the opportunity to take false contribution deductions on their tax return or false business expenses. If we could imagine for a moment, Mr. Chairman, that you were a physician, through USTPS you could claim $30,000 or $40,000 medical malpractice insurance premium when in fact you had no medical malpractice insurance from this particular firm. But the USTPS organization in the Caymans would provide to you as a doctor a medical malpractice insurance policy, it would provide you a premium notice, and of course, you would pay the amount on that premium notice.

The fraud here was that 90 percent of your premium payment, the $30,000 that was paid to this alleged insurance company, would not be deposited to a legitimate insurance company at all, but 90 percent of that $30,000 payment would be siphoned off and be deposited on your behalf into a corporate account in the Caymans. Again, the money is offshore. Once the money is offshore in that corporate account, which you control or have a substantial interest in, you then can direct that money to be returned to you by a variety of different means, either as a loan from the corporation, or you might perhaps choose to have your children receive a scholarship from this corporation.

Chairman **St Germain**. Let me ask. Did you say 90 percent of the money?

Mr. **Wassenaar**. Ninety percent.

Chairman **St Germain**. Where does the other 10 percent go?

Mr. **Wassenaar**. Ten percent went to the promoters or the sales people that were involved in this particular scheme.

Chairman **St Germain**. So, as a result thereof, the doctor has not bought any medical malpractice insurance.

Mr. **Wassenaar**. Absolutely. But if the doctor is audited and the auditor is zeroing in on the business deductions and asks the doctor to provide substantiation relative to this deduction, the doctor can show to the auditor an alleged insurance policy, an alleged premium notice, a real check made out to an alleged insurance company, fairly persuading evidence that the deduction on the tax return is indeed legitimate.

Chairman **St Germain**. But are you telling me that that doctor is taking a chance to launder, so to speak, this money and to go without medical malpractice insurance?

Mr. **Wassenaar**. Well, in some cases they were taking that risk. In other cases, they had two medical malpractice insurance companies that they were dealing with.

In addition to the medical malpractice scheme, if one of these doctors wanted to take a sizable charitable contribution, they could make out a check for $20,000 or $30,000 to this alleged church, and again, that check would go over to the Caymans, again 90 percent of the alleged contribution would be siphoned off and put into the doctor's bank account or into a corporate account under the doctor's control, and again, the promoters and the salespeople would keep the remaining 10 percent.

Chairman **St Germain**. How does the doctor then prove that he donated that money to a church?

Mr. WASSENAAR. Because he has a canceled check made out to the Church of Human Morality.

Chairman ST GERMAIN. The Church of Human Morality was part of the U.S. Tax Planning Service?

Mr. WASSENAAR. Right. That was all part of the scheme. They had a variety of different schemes like that that would enable you, regardless of what kind of business you were in, to take false or fictitious business expenses.

Chairman ST GERMAIN. The check was made out to the Church of Human Morality, not to Tax Planning Services.

Mr. WASSENAAR. That is right. The check was made out to the Church of Human Morality. It was then negotiated by the individuals behind tne USTPS shelter promotion. It was never deposited or given to the church.

Chairman ST GERMAIN. Did any such church exist?

Mr. WASSENAAR. A church of that nature does exist.

Chairman ST GERMAIN. What did you do, check with the church and see if they received the money?

Mr. WASSENAAR. I believe that was an offshore church.

Chairman ST GERMAIN. So you can't do that?

Mr. WASSENAAR. We are not very welcome in the Grand Caymans. In fact, I think we are forbidden to travel there on official purpose.

Chairman ST GERMAIN. OK. But if Doctor So and So or John Doe here in the United States is contributing to the Church of Human Morality, that does raise a little suspicion in your mind; doesn't it?

Mr. WASSENAAR. Yes.

Chairman ST GERMAIN. That is not too well conceived.

Mr. WASSENAAR. We certainly might be very suspicious to see a $30,000 or $20,000 contribution to the Church of Human Morality, but unless you can prove that it didn't exist, that that contribution was not made, I think for all practical purposes it would be an allowable deduction so long as indeed we could not disprove it being a church.

Chairman ST GERMAIN. If there are any doctors in the audience, you can contribute to the Church of Human Morality.

Mr. WASSENAAR. You get into some real constitutional questions when you attempt to determine what is and what is not a church.

Now, the magnitude of this particular scheme, USTPS, I think can be demonstrated by the fact that this scheme was being marketed in some 12 cities throughout the United States, and upon obtaining probable cause, which enabled us to execute search warrants in most of these cities, and having executed those search warrants, we were able to determine that there were roughly 3,000 U.S. citizens investing in this USTPS scheme, and at least half of that number involved physicians or doctors throughout this country.

Mr. WYLIE. Nobody involved in this scheme was required to file a CTR report, were they?

Mr. WASSENAAR. No.

Mr. WYLIE. So how did you catch them?

Mr. WASSENAAR. I'm just making a connection that in money laundering cases in almost all cases, it involves the use of a foreign bank. The point I'm trying to make is that the use of a foreign bank is not limited to just money laundering cases. These foreign banks are also used to commit other types of fiscal fraud upon the United States, and I use this as an example in that respect.

Mr. **Wylie**. You think there are some banks which are organized for the specific purpose of money laundering; I think you said that earlier?

Mr. **Wassenaar**. Oh, I think there is absolutely no doubt about that. Currently we have——

Mr. **Wylie**. Not in the United States, though.

Mr. **Wassenaar**. No; but of increasing and current concern to us is the fact that we have a number of investigations in process right now, and I'm not able to go into great detail, centering around money launderers or tax shelter promoters who have acquired or are acquiring, either directly or are in control of financial institutions which we know have been used or will be used to perpetrate their fraud and to commit their crimes.

I think in my prepared statement I also give an example of a case that was worked by the Drug Enforcement Administration, worked successfully in terms of prosecuting this narcotics trafficker who indeed owned a controlling interest in the Sunshine Bank in Florida.

Mr. **Wylie**. I want to ask a couple more questions, but I guess you have some more of your prepared statement you want to finish.

Mr. **Wassenaar**. I'm ready for questions now.

[The prepared statement of Richard Wassenaar can be found in the appendix.]

Mr. **Wylie**. You have been involved in a lot of money laundering cases?

Mr. **Wassenaar**. Yes; some 800 cases since 1981.

Mr. **Wylie**. 800 cases. Money launderers are getting around the reporting requirement through using Smurfs who purchase less than $10,000 cashier checks. Do you think that the limit should be reduced, or would that help?

Mr. **Wassenaar**. Well, that's a possibility. I would rather see what I think can be accommodated in Mr. Pickle's bill, that first of all, there be an attempt provision within the law and that it be a specific crime to structure your transactions in such a manner to intentionally avoid the Bank Secrecy Act. I think that would help in most of the Smurfing operations.

Mr. **Wylie**. That would help. OK.

Mr. **Wassenaar**. It would certainly limit the Smurfs to $10,000 a day, or less than $10,000 a day.

Mr. **Wylie**. Do you think money laundering should be made a criminal activity?

Mr. **Wassenaar**. I think it should, absolutely. You know, an analogy might be that if there were no Federal crime for armed robbery of a bank, then you force the investigators and the prosecutors to use perhaps a violation of failure to register a weapon, when the real crime is robbing the bank.

I think the same thing is true here. We have been I think, quite successful in convicting money launderers, but not on the crime of money laundering itself, but on violations of the Bank Secrecy Act.

Mr. **Wylie**. Under the law, we require financial institutions, brokers, insurance companies, currency exchangers—and one of your cases involved a currency exchanger—pawnbrokers and even casinos to file currency transaction reports. Are we missing anyone, based on your experience as an investigator in money laundering cases?

Mr. **Wassenaar**. Whoever we are missing under the Bank Secrecy Act, we are picking up under the Internal Revenue Code because Congress passed a law about a year ago wherein any business that is not subject to reporting under the Bank Secrecy Act must file a similar form with the Internal Revenue Service under the Internal Revenue Code, a form 8300, which calls for essentially the same type of information. That would cover automobile dealers, any type of business where a transaction in excess of $10,000 is involved.

Mr. **Wylie**. Thank you.

Thank you for your testimony. Thank you, Mr. Chairman.

Chairman **St Germain**. Mr. Torres, do you have questions you would like to ask?

Mr. **Torres**. No, Mr. Chairman, only simply to thank the witness for illuminating evidence and testimony. Thank you, sir.

Chairman **St Germain**. To put it another way, we thank you for the Sunshine State Bank. That was in Miami?

Mr. **Wassenaar**. It was in Florida.

BANK ADDRESS

The Sunshine State Bank is located at 5975 Sunset Drive in South Miami, Florida.

Chairman **St Germain**. Your statement says Miami. Which was the one in Largo or Clearwater about a year and a half to two years ago? You don't remember that one?

Mr. **Wassenaar**. That perhaps was a Great America Bank.

Chairman **St Germain**. The fellow who controlled that bank had a rather salubrious past; didn't he?

Mr. **Wassenaar**. Yes.

Chairman **St Germain**. You wonder how he ever was allowed to come into control of that bank. That is not for you to answer. That is for us to query of the regulators. I will ask my staff to obtain the exact name of the bank so we can ask the proper agency tomorrow to explain that one for us.

Mr. **Wassenaar**. Thank you for getting me off the hook.

Chairman **St Germain**. Mr. Wassenaar, we want to thank you for your help this morning. We have a number of technical questions we will submit to you in writing. I think we have kept you here long enough. We want, in view of your caseload, you to get back to work, and continue.

Mr. **Wassenaar**. Thank you. We indeed appreciate your interest.

Chairman **St Germain**. Thank you. The subcommittee stands adjourned until 9:30 a.m. tomorrow morning. We do have some documents that will be submitted into the record at this point.

[The documents referred to can be found in the appendix.]

[Whereupon, at 1:30 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

APPENDIX

STATEMENT OF
THE HONORABLE J. J. PICKLE
BEFORE THE HOUSE SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE
WEDNESDAY, APRIL 16, 1986

MR. CHAIRMAN, IT IS AN HONOR TO APPEAR BEFORE YOU TODAY TO EXPLAIN MY NEW BILL TO COMBAT MONEY LAUNDERING.

THE OVERSIGHT SUBCOMMITTEE OF THE COMMITTEE ON WAYS AND MEANS HAS INVESTIGATED PROBLEMS ASSOCIATED WITH MONEY LAUNDERING. THE SUBCOMMITTEE HELD A HEARING, LAST YEAR, FOCUSING SPECIFICALLY ON THE RESPONSIBILITIES OF THE INTERNAL REVENUE SERVICE IN THIS AREA. IN ADDITION, SEVERAL MEMBERS OF THE SUBCOMMITTEE TOURED THE IRS TRAINING FACILITIES AT THE FEDERAL LAW ENFORCEMENT TRAINING CENTER IN GLYNCO, GEORGIA TO LEARN MORE ABOUT THE IRS ENFORCEMENT IN THIS AREA.

OUR SUBCOMMITTEE'S INVESTIGATION RESULTED IN TWO IMPORTANT FINDINGS. WE FOUND THAT BECAUSE OF LOOPHOLES IN THE CURRENT LAW, THE GOVERNMENT HAS BEEN UNABLE TO SUCCESSFULLY PROSECUTE THE PERSON WHO PUTS TOGETHER SCHEMES THAT ALLOW ILLEGAL SOURCE CASH TO BE "LAUNDERED". WE ALSO FOUND THAT PROBLEMS EXISTED IN THE ABILITY OF IRS TO SEIZE ILLEGAL SOURCE INCOME WHEN A CRIMINAL, SUCH AS THE DRUG DEALER, LAUNDERS HIS ILLEGAL SOURCE INCOME THROUGH DOMESTIC FINANCIAL INSTITUTIONS.

WE AS A NATION, ARE LOSING OUR BATTLE AGAINST THE FLOW OF ILLEGAL DRUGS. MONEY LAUNDERING IS AN INTRICATE PART OF THE DRUG TRAFFICKING PROCESS. THEREFORE, ANY EFFORTS TO TRY TO STOP THE DRUG TRAFFIC MUST STOP THE MONEY LAUNDERING ASSOCIATED WITH IT. ALSO, I SHOULD POINT OUT THAT BUSINESSES AND INDIVIDUALS IN THE U.S. ARE LAUNDERING INCOME, FROM BOTH ILLEGAL AND LEGAL ACTIVITIES. THIS PROBLEM IS A GROWING ONE. AS A RESULT, I AM CONCERNED ABOUT THE IMPACT OF MONEY LAUNDERING OPERATIONS ON THE COLLECTION OF U.S. FEDERAL INCOME TAXES.

AS MEMBERS OF THIS SUBCOMMITTEE ARE AWARE, THE ENFORCEMENT OF THE BANK SECRECY ACT REPORTING REQUIREMENTS IS THE RESPONSIBILITY OF THE SECRETARY OF THE TREASURY, WHO HAS DELEGATED HIS AUTHORITY TO THE IRS. UNDER CURRENT LAW, DOMESTIC FINANCIAL INSTITUTIONS MUST REPORT CASH TRANSACTIONS OF $10,000 OR MORE TO THE INTERNAL REVENUE SERVICE. IN A TYPICAL SCHEME, MONEY LAUNDERERS OFTEN BREAK UP LARGE SUMS OF MONEY, INTO TRANSACTIONS OF LESS THAN $10,000, TO AVOID HAVING THE FINANCIAL INSTITUTIONS REPORT THE CASH.

I ASKED THE ADMINISTRATION TO WORK WITH ME IN DRAFTING LEGISLATION THAT WILL CLOSE LOOPHOLES IN THE LAW THAT HAVE NOT ALLOWED THE GOVERNMENT TO SUCCESSFULLY CONVICT MONEY

BEST COPY AVAILABLE

LAUNDERERS AND WILL GIVE THE IRS ADEQUATE SEIZURE AND FORFEITURE AUTHORITY. THE BILL THAT I INTRODUCED YESTERDAY, "THE MONEY LAUNDERING PREVENTION ACT OF 1986", REPRESENTS THE RESULTS OF THIS JOINT EFFORT. THIS BILL WAS DRAFTED BY THE ADMINISTRATION IN CLOSE CONSULTATION WITH MY STAFF. THE BILL CLOSES THE LOOPHOLES IN CURRENT LAW WHICH ALLOW THE MONEY LAUNDERER TO ESCAPE CONVICTION AND PROVIDES THE IRS WITH SEIZURE AND FORFEITURE AUTHORITY WHEN THERE ARE VIOLATIONS OF BANK SECRECY ACT REPORTING REQUIREMENTS.

THE BILL, AS DRAFTED, IS UNDER THE JURISDICTION OF YOUR COMMITTEE. I HOPE THAT YOU WILL EVALUATE THIS LEGISLATION AND IT WILL BE HELPFUL AS YOU IMPROVE THE BANK SECRECY ACT.

BEFORE I OUTLINE MY BILL, I THINK ONE THING SHOULD BE MADE CLEAR. THE ADMINISTRATION HAS DEVELOPED ITS OWN COMPREHENSIVE APPROACH TO ADDRESS THE ENTIRE AREA OF MONEY LAUNDERING. THEIR PROPOSALS ARE BEING ACTIVELY WORKED ON IN THE HOUSE AND SENATE JUDICIARY COMMITTEES. I ENCOURAGE ALL EFFORTS IN THIS AREA.

MY BILL, WHICH HAS THE ADMINISTRATION'S SUPPORT, IS DESIGNED TO COMPLEMENT OTHER MONEY LAUNDERING PROPOSALS. MY BILL, EVEN IF IT IS ENACTED ON ITS OWN, WILL BE A USEFUL ADDITION TO CURRENT LAW IN COMBATING MONEY LAUNDERING ACTIVITIES.

LET ME BRIEFLY OUTLINE THIS LEGISLATION:

--- SECTION 1 OF MY BILL EXPRESSLY SUBJECTS PERSONS TO CRIMINAL AND CIVIL LIABILITY WHERE THEY "CAUSE" OR "ATTEMPT TO CAUSE" AN INSTITUTION TO FAIL TO FILE A REQUIRED REPORT OR TO FILE AN INCORRECT REPORT. THIS WILL BE HELPFUL IN NOT ONLY GETTING THE SMURF WHO DOES THE ACTUAL TRANSACTION, BUT ALSO THOSE WHO PLAN THE ACTIVITY. THIS WOULD ALSO ALLOW TREASURY AND IRS TO ACT BEFORE THE 15 DAYS THE FINANCIAL INSTITUTION HAS TO FORMALLY FILE A CTR REPORT.

ALSO, THE BILL MAKES IT AN OFFENSE TO "STRUCTURE" OR TO "ASSIST IN STRUCTURING" A TRANSACTION TO EVADE THE REPORTING REQUIREMENTS. FOR EXAMPLE, THIS PROVISION WOULD PROHIBIT THE STRUCTURING OF A TRANSACTION TO CIRCUMVENT THE REPORTING REQUIREMENTS BY INVOLVING TWO OR MORE FINANCIAL INSTITUTIONS.

--- SECTION 2 OF MY BILL ALLOWS FORFEITURE AND SEIZURE AUTHORITY TO BE USED BY THE IRS TO SEIZE LAUNDERED CASH AND PROPERTY "DIRECTLY TRACEABLE" TO THE LAUNDERED CASH. THUS, BOTH THE IRS AND THE CUSTOMS SERVICE WILL BE ABLE TO USE SEIZURE AND FORFEITURE AUTHORITY MORE EFFECTIVELY TO GET THE MONEY OR THE PROPERTY BEFORE IT DISAPPEARS.

HOWEVER, THERE ARE PROTECTIONS IN MY BILL FOR INNOCENT THIRD PARTIES. IF A PERSON PROVES HE WAS A GOOD FAITH "BONA FIDE PURCHASER" OR COULD PROVE THAT IT WAS NOT A "WILLFUL" VIOLATION, HE WOULD NOT BE SUBJECT TO FORFEITURE.

--- SECTION 3 OF MY LEGISLATION PROVIDES A NEW CIVIL PENALTY FOR VIOLATIONS OF THE BANK SECRECY ACT. THE AMOUNT OF THE PENALTY WOULD BE THE DIFFERENCE BETWEEN THE AMOUNT FORFEITED UNDER SECTION 2 AND THE TOTAL AMOUNT OF THE LAUNDERING TRANSACTION. AGAIN, THE STANDARD FOR THIS NEW CIVIL PENALTY WOULD BE A "WILLFUL" VIOLATION.

IN CONCLUSION, MR. CHAIRMAN, I BELIEVE THE NEED FOR THIS LEGISLATION IS OBVIOUS. FEDERAL COURTS HAVE TAKEN THE POSITION THAT THERE IS INADEQUATE LEGISLATIVE AUTHORITY TO PROSECUTE PEOPLE WHO ARE ACTIVELY ENGAGED IN MONEY LAUNDERING OPERATIONS. AT A MINIMUM, THIS LOOPHOLE SHOULD BE CLOSED FOREVER. UNDER MY BILL, IT WOULD BE.

ALSO, FOR THE FIRST TIME, THIS LEGISLATION WILL ALLOW THE INTERNAL REVENUE SERVICE TO SEIZE AND FORFEIT CASH AND PROPERTY THAT IS INVOLVED IN A VIOLATION OF THE BANK SECRECY ACT. AS MEMBERS OF THIS SUBCOMMITTEE MAY KNOW, LAUNDERED MONEY CANNOT BE SEIZED BECAUSE THERE IS DIFFICULTY IN PROVING THAT THERE IS A "NEXUS" BETWEEN THE LAUNDERED MONEY AND A CRIMINAL ACTIVITY. IN MOST CASES, THE CASE INVOLVES ILLEGAL DRUGS. MY BILL ALSO REPRESENTS A CAREFUL EFFORT TO STRENGTHEN IRS ENFORCEMENT AUTHORITY AGAINST MONEY LAUNDERING, WHILE AT THE SAME TIME, TO PROTECT THIRD PARTIES.

I AM ENCLOSING, FOR THE RECORD, A COPY OF MY BILL WITH A DETAILED SECTION-BY-SECTION EXPLANATION.

FERNAND J. ST GERMAIN, RHODE ISLAND, CHAIRMAN
FRANK ANNUNZIO, ILLINOIS
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SUPERVISION, REGULATION AND INSURANCE
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MARGE ROUKEMA, NEW JERSEY
DOUG BEREUTER, NEBRASKA
STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

March 27, 1986

Commissioner Roscoe L. Egger, Jr.
Office of Commissioner of Internal
Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Commissioner Egger:

On April 16, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will begin hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity. It is requested that Richard Wassenaar, Assistant Commissioner (Criminal Investigation) and Percy P. Woodard, Jr., Assistant Commissioner (Examination) appear before the Subcommittee to discuss these matters which are more fully explained in this letter of invitation.

Mr. Wassenaar should appear before the Subcommittee on Wednesday, April 16, 1986, at 10:00 a.m., and Mr. Woodard should appear before the Subcommittee on Thursday, April 17, at 10:00 a.m., in Room 2128 Rayburn House Office Building.

For your information, last year the Subcommittee held three days of hearings on this nation's financial institutions' compliance with the currency and foreign transactions reporting requirements under the Bank Secrecy Act (BSA) and the administrative efforts of the banking regulators to fulfill their responsibilities to enforce such compliance. A major focus of this Subcommittee's attention centered on the Bank of Boston's failure to comply with certain provisions of the BSA which resulted in that institution's plea of guilty to knowingly and willfully violating the law.

At that time, I stated that the Subcommittee was determined to find out how widespread the noncompliance had become and to find out why. Subsequent to the Bank of Boston hearing, a number of financial institutions, voluntarily -- and some not -- came forward "confessing" that they too had violated the law. Since then, information received by the Subcommittee indicates that as of February 14, 1986, 13 banks or holding companies have entered into civil settlements with the Treasury Department and have paid over $10 million in fines. This seems to confirm the Subcommittee's early suspicions that BSA violations are widespread and extremely serious.

In that regard, the Subcommittee will continue to examine efforts undertaken by the Treasury, IRS, and banking regulators to improve their enforcement procedures of the BSA in the series of hearings beginning on April 16. It is my understanding that since March of 1985, the IRS has increased its commitment of staff resources in enforcing the provisions of the Bank Secrecy Act. This increase in commitment includes a greater effort in the processing and computerization of the large increase in currency transaction reports. It is also my understanding that IRS agreed in late 1985 to assume the day-to-day responsibility for reviewing exemptions from CTR reporting requirements and approving special exemptions pursuant to current regulations. The testimony of IRS in these and other related administrative matters would be extremely beneficial to the Subcommittee.

It has become apparent that limiting the Subcommittee's review to BSA provisions, as important as that is, does not fully address the grievous problems that currently exist with respect to criminal elements in our society using financial institutions for tax evasion, drug trafficking, money laundering, and other criminal activity. Therefore, the Subcommittee intends to revisit other banking statutes and to review a number of bills that have been referred to the Banking Committee, which bills are generally referred to as "money laundering" legislation.

In addition, it is important that the Subcommittee have an understanding of the many schemes used by tax evaders, drug traffickers, money launderers, and others. In that regard, it would be most beneficial to the Subcommittee if IRS could provide in its testimony various examples of how these schemes develop, what success the Service has had in combatting these activities, and especially how depository institutions are used to facilitate these schemes.

There are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

The Subcommittee would appreciate any comments or opinions which the Service might have with respect to the aforementioned Titles that you believe would provide guidance to us in these matters.

Please provide the Subcommittee with 175 copies of your testimony no later than 24 hours in advance of the appearance of each witness. Please have your staff contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Chairman

FERNAND J. ST GERMAIN, RHODE ISLAND, CHAIRMAN
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STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

March 27, 1986

The Honorable James A. Baker III
Secretary of the Treasury
Washington, D.C. 20220

Dear Mr. Secretary:

On April 16, 1986, the Subcommittee will begin hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity. It is requested that Francis A. Keating II, Assistant Secretary (Enforcement and Operations) appear before the Subcommittee on Thursday, April 17, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building, to discuss these matters which are more fully explained in this letter of invitation.

As you know, last year the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held three days of hearings on this nation's financial institutions' compliance with the currency and foreign transactions reporting requirements under the Bank Secrecy Act (BSA) and the administrative efforts of the banking regulators to fulfill their responsibilities to enforce such compliance. A major focus of this Subcommittee's attention centered on the Bank of Boston's failure to comply with certain provisions of the BSA which resulted in that institution's plea of guilty to knowingly and willfully violating the law.

At that time, I stated that the Subcommittee was determined to find out how widespread the noncompliance had become and to find out why. Subsequent to the Bank of Boston hearing, a number of financial institutions, voluntarily -- and some not -- came forward "confessing" that they too had violated the law. Since then, information received by the Subcommittee indicates that as of February 14, 1986, 13 banks or holding companies have entered into civil settlements with the Treasury Department and have paid over $10 million in fines. This seems to confirm the Subcommittee's early

suspicions that BSA violations are widespread and extremely serious.

In that regard, the Subcommittee will continue to examine efforts undertaken by the banking regulators to improve their enforcement procedures of the BSA in the series of hearings beginning on April 16. In accordance with my request of January 14, 1986, the Subcommittee appreciates the written report submitted by Assistant Secretary Keating concerning the activities of the Office of Enforcement and Operations to promote the compliance of financial institutions with the provisions of the Bank Secrecy Act. In his testimony on April 17, the Committee would appreciate an update of that report and any additional information which your office deems relevant to the subject matter before us.

It has become apparent that limiting the Subcommittee's review to BSA provisions, as important as that is, does not fully address the grievous problems that currently exist with respect to criminal elements in our society using financial institutions for tax evasion, drug trafficking, money laundering, and other criminal activity. Therefore, the Subcommittee intends to revisit other banking statutes and to review the number of bills that have been referred to the Banking Committee, which bills are generally referred to as "money laundering" legislation.

There are four Titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

Your response to the following questions and any other comments you feel are pertinent to the issues raised would be appreciated.

Title I (Supervisory Authority Over Depository Institutions)

In 1978 Congress gave banking regulators authority to impose civil money penalties for violations of laws, rules and orders. The new authority gave the agencies the flexibility they needed to impose penalties on individuals or institutions for violations which did not rise to a criminal violation.

A. Specifically, is there any merit to considering giving the regulators authority to impose civil money penalties upon financial institutions for their failure to report under BSA, or should the Treasury continue to have the authority to impose such penalties?

B. To what extent could these powers be improved upon to lend support in appropriate cases to criminal law enforcement investigations?

C. To what extent, if any, might the supervisory powers over depository institutions under existing law be extended to uncover criminal activities such as tax evasion, drug trafficking or money laundering, which could affect the safety and soundness of a financial institution?

Title VI and VII (Change in Bank Control Act and Change in Savings and Loan Control Act

The Safe Banking Act of 1978 corrected, to a great extent, one of the most glaring gaps in the regulatory structure of our depository institutions, i.e., the lack of control over transfers of ownership of banks and savings and loans between individuals or groups of individuals. However, in light of certain ongoing criminal activities, the Change in Bank Control Act may need to be amended.

A. What modifications, if any, do you feel are necessary to deny acquisitions of control to unqualified or dishonest individuals?

B. Should more specific standards regarding what constitutes sufficient integrity or criteria used to determine what would not be in the best interest of the depositors or the public, be included by statute or imposed by regulation?

C. Should the agency be given more time in which to disapprove an application for change of control (currently within 60 days, not to exceed 90 under certain circumstances)?

D. What is the standard used for the term "willful" under the Act? Does this definition create problems for the agency? If so, what are they?

E. What problems, if any, is the agency incurring in obtaining sufficient relevant information of foreign nationals seeking to acquire U.S. depository institutions?

Title XI (Right to Financial Privacy Act)

As you know, the Right to Financial Privacy Act gives individuals notice of, and a chance to challenge, federal government agency requests for their bank records. In 1978 this Committee sought to strike a balance between a customer's right of privacy and the need of law enforcement agencies to obtain financial records pursuant to legitimate investigations. Today, our goals are not any different from what they were in 1978. However, some law enforcement officials have suggested that the 1978 Act is at times an impediment to legitimate law enforcement investigations. Indeed, the Administration's bill, H.R. 2785, would deny the customer's financial privacy protection under the Act under certain circumstances. The Subcommittee would welcome your comments on the experiences you have had with right to financial privacy concerns, and whether in your opinion amendments to the Right to Financial Privacy Act are warranted.

"Money Laundering Bills"

As noted above, several bills dealing with money laundering, but having impact on various banking and other statutory law have been referred to the Banking Committee. The Subcommittee intends to review these proposals and would appreciate your comments and analyses of them. The bills we intend to review are: H.R. 2785 (Administration's bill), H.R. 1367 (McCollum), H.R. 1945 (Hubbard), H.R. 1474 (Hughes), H.R. 3892 (Wortley), and H.R. 4280 (Torres).

Please provide the Subcommittee with 175 copies of Assistant Secretary Keating's testimony, and 175 additional copies of the BSA report, no later than April 16, 1986. Please have your staff contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Chairman

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STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

March 27, 1986

Mr. L. William Seidman
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Dear Mr. Chairman:

On April 16, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will begin hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity. It is requested that you appear before the Subcommittee on Thursday, April 17, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building, to discuss these matters which are more fully explained in this letter of invitation.

For your information, last year the Subcommittee held three days of hearings on this nation's financial institutions' compliance with the currency and foreign transactions reporting requirements under the Bank Secrecy Act (BSA) and the administrative efforts of the banking regulators to fulfill their responsibilities to enforce such compliance. A major focus of this Subcommittee's attention centered on the Bank of Boston's failure to comply with certain provisions of the BSA which resulted in that institution's plea of guilty to knowingly and willfully violating the law.

At that time, I stated that the Subcommittee was determined to find out how widespread the noncompliance had become and to find out why. Subsequent to the Bank of Boston hearing, a number of financial institutions, voluntarily -- and some not -- came forward "confessing" that they too had violated the law. Since then, information received by the Subcommittee indicates that as of February 14, 1986, 13 banks or holding companies have entered into civil settlements with the Treasury Department and have paid over $10 million in fines. This seems to confirm the Subcommittee's early

suspicions that BSA violations are widespread and extremely serious.

In that regard, the Subcommittee will continue to examine efforts undertaken by the Treasury, IRS and banking regulators to improve their enforcement procedures of the BSA in the series of hearings beginning on April 16. Accordingly, please submit to the Subcommittee, no later than April 11, a written report updating your agency's efforts to improve enforcement efforts of the BSA since January 1, 1985. Such report should include, but is not limited to, the following:

1. The number of institutions examined by your agency since January 1, 1985 and the number and type of violations of the BSA found at these institutions, and actions taken by your agency on these violations.

2. Describe the training programs given to your examiners in BSA techniques and procedures. What improvements, if any, have been made since January 1, 1985?

3. Describe efforts your agency has undertaken to improve communication with law enforcement agencies. What legal or policy impediments still exist that interfere with an open communication between the agency and law enforcement officials. Are they justified, in your opinion?

4. Describe the progress, if any, that has been made between your agency and the Federal Reserve regarding the type of currency shipment reports that are made available by the Fed. Has your agency made use of such reports? Be specific.

5. Describe the management controls over implementation of BSA responsibilities that were in place before January 1, 1985 and changes, if any, since that time.

6. Describe the initiatives your agency has taken to broaden the knowledge of and exposure to reporting requirements of the BSA for those institutions you regulate.

7. Describe the role your agency played in the Attorney General's Bank Fraud Working Group. Cite specific examples on how your agency has implemented that agreement.

8. Submit copies of all revised regulations, banking circulars, newsletters, internal communications, updates to manual for examiners, and any other written information pertaining to enforcement efforts of the BSA undertaken by your agency since January 1, 1985.

It has become apparent that limiting the Subcommittee's review to BSA provisions, as important as that is, does not fully address the grievous problems that currently exist with respect to criminal elements in our society using financial institutions for tax evasion, drug trafficking, money laundering, and other criminal activity. Therefore, the Subcommittee intends to revisit other banking statutes and to review a number of bills that have been referred to the Banking Committee, which bills are generally referred to as "money laundering" legislation.

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Your response to the following questions and any other comments you feel are pertinent to the issues raised would be appreciated.

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A. Specifically, is there any merit to considering giving the regulators authority to impose civil money penalties upon financial institutions for their failure to report under BSA, or should the Treasury continue to have the authority to impose such penalties?

B. To what extent could these powers be improved upon to lend support in appropriate cases to criminal law enforcement investigations?

C. To what extent, if any, might the supervisory powers over depository institutions under existing law be extended to uncover criminal activities such as tax evasion, drug trafficking or money laundering, which could affect the safety and soundness of a financial institution?

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A. What modifications, if any, do you feel are necessary to deny acquisitions of control to unqualified or dishonest individuals?

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Title XI (Right to Financial Privacy Act)

As you know, the Right to Financial Privacy Act gives individuals notice of, and a chance to challenge, federal government agency requests for their bank records. In 1978

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this Committee sought to strike a balance between a customer's right of privacy and the need of law enforcement agencies to obtain financial records pursuant to legitimate investigations. Today, our goals are not any different from what they were in 1978. However, some law enforcement officials have suggested that the 1978 Act is at times an impediment to legitimate law enforcement investigations. Indeed, the Administration's bill, H.R. 2785, would deny the customer's financial privacy protection under the Act under certain circumstances. The Subcommittee would welcome your comments on the experiences you have had with right to financial privacy concerns, and whether in your opinion amendments to the Right to Financial Privacy Act are warranted.

"Money Laundering Bills"

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Please provide the Subcommittee with 175 copies of your testimony, and 175 additional copies of the BSA report, no later than April 16, 1986. Please have your staff contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Chairman

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DOUG BEREUTER, NEBRASKA
STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

March 27, 1986

Mr. Robert L. Clarke
Comptroller of the Currency
490 L'Enfant Plaza East S.W.
Washington, D.C. 20219

Dear Mr. Clarke:

On April 16, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will begin hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity. It is requested that you appear before the Subcommittee on Thursday, April 17, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building, to discuss these matters which are more fully explained in this letter of invitation.

For your information, last year the Subcommittee held three days of hearings on this nation's financial institutions' compliance with the currency and foreign transactions reporting requirements under the Bank Secrecy Act (BSA) and the administrative efforts of the banking regulators to fulfill their responsibilities to enforce such compliance. A major focus of this Subcommittee's attention centered on the Bank of Boston's failure to comply with certain provisions of the BSA which resulted in that institution's plea of guilty to knowingly and willfully violating the law.

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suspicions that BSA violations are widespread and extremely serious.

In that regard, the Subcommittee will continue to examine efforts undertaken by the Treasury, IRS and banking regulators to improve their enforcement procedures of the BSA in the series of hearings beginning on April 16. Accordingly, please submit to the Subcommittee, no later than April 11, a written report updating your agency's efforts to improve enforcement efforts of the BSA since January 1, 1985. Such report should include, but is not limited to, the following:

1. The number of institutions examined by your agency since January 1, 1985 and the number and type of violations of the BSA found at these institutions, and actions taken by your agency on these violations.

2. Describe the training programs given to your examiners in BSA techniques and procedures. What improvements, if any, have been made since January 1, 1985?

3. Describe efforts your agency has undertaken to improve communication with law enforcement agencies. What legal or policy impediments still exist that interfere with an open communication between the agency and law enforcement officials. Are they justified, in your opinion?

4. Describe the progress, if any, that has been made between your agency and the Federal Reserve regarding the type of currency shipment reports that are made available by the Fed. Has your agency made use of such reports? Be specific.

5. Describe the management controls over implementation of BSA responsibilities that were in place before January 1, 1985 and changes, if any, since that time.

6. Describe the initiatives your agency has taken to broaden the knowledge of and exposure to reporting requirements of the BSA for those institutions you regulate.

7. Describe the role your agency played in the Attorney General's Bank Fraud Working Group. Cite specific examples on how your agency has implemented that agreement.

8. Submit copies of all revised regulations, banking circulars, newsletters, internal communications, updates to manual for examiners, and any other written information pertaining to enforcement efforts of the BSA undertaken by your agency since January 1, 1985.

It has become apparent that limiting the Subcommittee's review to BSA provisions, as important as that is, does not fully address the grievous problems that currently exist with respect to criminal elements in our society using financial institutions for tax evasion, drug trafficking, money laundering, and other criminal activity. Therefore, the Subcommittee intends to revisit other banking statutes and to review a number of bills that have been referred to the Banking Committee, which bills are generally referred to as "money laundering" legislation.

There are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

Your response to the following questions and any other comments you feel are pertinent to the issues raised would be appreciated.

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In 1978 Congress gave banking regulators authority to impose civil money penalties for violations of laws, rules and orders. The new authority gave the agencies the flexibility they needed to impose penalties on individuals or institutions for violations which did not rise to a criminal violation.

A. Specifically, is there any merit to considering giving the regulators authority to impose civil money penalties upon financial institutions for their failure to report under BSA, or should the Treasury continue to have the authority to impose such penalties?

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B. To what extent could these powers be improved upon to lend support in appropriate cases to criminal law enforcement investigations?

C. To what extent, if any, might the supervisory powers over depository institutions under existing law be extended to uncover criminal activities such as tax evasion, drug trafficking or money laundering, which could affect the safety and soundness of a financial institution?

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The Safe Banking Act of 1978 corrected, to a great extent, one of the most glaring gaps in the regulatory structure of our depository institutions, i.e., the lack of control over transfers of ownership of banks and savings and loans between individuals or groups of individuals. However, in light of certain ongoing criminal activities, the Change in Bank Control Act may need to be amended.

A. What modifications, if any, do you feel are necessary to deny acquisitions of control to unqualified or dishonest individuals?

B. Should more specific standards regarding what constitutes sufficient integrity or criteria used to determine what would not be in the best interest of the depositors or the public, be included by statute or imposed by regulation?

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D. What is the standard used for the term "willful" under the Act? Does this definition create problems for the agency? If so, what are they?

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Title XI (Right to Financial Privacy Act)

As you know, the Right to Financial Privacy Act gives individuals notice of, and a chance to challenge, federal government agency requests for their bank records. In 1978

this Committee sought to strike a balance between a customer's right of privacy and the need of law enforcement agencies to obtain financial records pursuant to legitimate investigations. Today, our goals are not any different from what they were in 1978. However, some law enforcement officials have suggested that the 1978 Act is at times an impediment to legitimate law enforcement investigations. Indeed, the Administration's bill, H.R. 2785, would deny the customer's financial privacy protection under the Act under certain circumstances. The Subcommittee would welcome your comments on the experiences you have had with right to financial privacy concerns, and whether in your opinion amendments to the Right to Financial Privacy Act are warranted.

"Money Laundering Bills"

As noted above, several bills dealing with money laundering, but having impact on various banking and other statutory law have been referred to the Banking Committee. The Subcommittee intends to review these proposals and would appreciate your comments and analyses of them. The bills we intend to review are: H.R. 2785 (Administration's bill), H.R. 1367 (McCollum), H.R. 1945 (Hubbard), H.R. 1474 (Hughes), H.R. 3892 (Wortley), and H.R. 4280 (Torres).

Please provide the Subcommittee with 175 copies of your testimony, and 175 additional copies of the BSA report, no later than April 16, 1986. Please have your staff contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J St Germain
Chairman

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FERNAND J. ST GERMAIN RHODE ISLAND CHAIRMAN
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THOMAS J MANTON NEW YORK

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

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STEVE BARTLETT TEXAS
TOBY ROTH WISCONSIN

March 27, 1986

Mr. Edwin J. Gray, Chairman
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, D.C. 20552

Dear Mr. Gray:

On April 16, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will begin hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity. It is requested that you appear before the Subcommittee on Thursday, April 17, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building, to discuss these matters which are more fully explained in this letter of invitation.

For your information, last year the Subcommittee held three days of hearings on this nation's financial institutions' compliance with the currency and foreign transactions reporting requirements under the Bank Secrecy Act (BSA) and the administrative efforts of the banking regulators to fulfill their responsibilities to enforce such compliance. A major focus of this Subcommittee's attention centered on the Bank of Boston's failure to comply with certain provisions of the BSA which resulted in that institution's plea of guilty to knowingly and willfully violating the law.

At that time, I stated that the Subcommittee was determined to find out how widespread the noncompliance had become and to find out why. Subsequent to the Bank of Boston hearing, a number of financial institutions, voluntarily -- and some not -- came forward "confessing" that they too had violated the law. Since then, information received by the Subcommittee indicates that as of February 14, 1986, 13 banks or holding companies have entered into civil settlements with the Treasury Department and have paid over $10 million in fines. This seems to confirm the Subcommittee's early

suspicions that BSA violations are widespread and extremely serious.

In that regard, the Subcommittee will continue to examine efforts undertaken by the Treasury, IRS and banking regulators to improve their enforcement procedures of the BSA in the series of hearings beginning on April 16. Accordingly, please submit to the Subcommittee, no later than April 11, a written report updating your agency's efforts to improve enforcement efforts of the BSA since January 1, 1985. Such report should include, but is not limited to, the following:

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Please provide the Subcommittee with 175 copies of your testimony, and 175 additional copies of the BSA report, no later than April 16, 1986. Please have your staff contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J St Germain

Fernand J St Germain
Chairman

STATEMENT OF HERB FRIEDBERG

My name is Herb Friedberg. I am fifty-three years old and a former resident of Miami, Florida. Between 1980 and 1983 I worked as a property manager for an apartment complex in Miami where I came into contact with Jacques Behar, a resident of the apartment complex. Mr. Behar and myself became fairly well acquainted on a social and professional basis.

In June, 1983, I lost my employment a result of a back injury. Several months later, I stopped receiving disability compensation and needed additional income. In December, 1983, Mr. Behar contacted me and asked if I could write him a personal check for $5,000.00 in exchange for U.S. Currency. I did this for Mr. Behar as a favor and received no compensation. Shortly thereafter, Mr. Behar asked me to purchase a cashier's check for him in the amount of $7,500.00 using my personal checking account in Miami. I did this for Mr. Behar who claimed that he was too busy to purchase the check himself. I received $50.00 from Mr. Behar for performing this service.

During the first few months of 1984, I made additional purchases of cashier's checks for Mr. Behar to supplement my personal income. By March, 1984, I was purchasing cashier's checks on a weekly basis for Mr. Behar using cash he provided me in large amounts well in excess of $10,000. Mr. Behar instructed me to purchase these checks at different banks in Miami and to keep all check amounts under $10,000 at any particular bank. To do this, I needed to open additional accounts under my own name at eight or nine banks in the Miami area. Mr. Behar also provided me with certain names to use on a random basis as payees on the cashier's checks or told me to make up any "Latin-sounding" names to use as payees on the checks. I also used fictitious "remitter" names on cashier's checks application forms used by the various Miami banks. Initially, I was unaware of any law requiring the filing of a Currency Transaction Report by the banks I visited or that I was being used by Mr. Behar to avoid the CTR requirements. By April, 1984, I was receiving approximately $50,000 a week from Mr. Behar and purchasing cashier's checks and money orders in amounts under $10,000 at various Miami banks as instructed by Mr. Behar. I was not suspicious of this activity becuase Mr. Behar had explained to me that he did money exchanges as part of his business and I knew of nothing illegal in making these check purchases.

In May, 1984, Mr. Behar instructed me and another individual, known to me as "Pepe", to go to California to pick up $200,000 in cash from someone named "Hecho" and exchange that money for cashier's checks in the Los Angeles area. Pepe and I traveled to Los Angeles and contacted "Hecho" using a telephone beeper number provided by Mr. Behar. Pepe and I then met with "Hecho" at a residence in Palos Verde, California where we picked up $200,000 in U.S. currency. My curiosity was particularly aroused by this money pick-up in that the palacial residence occupied by "Hecho" was furnished only with mattresses on the floor and bed sheets covering the windows. Also, "Hecho" gave us this $200,000 without question or conversation on what was to be done with the money. Pepe and I took this money and went from bank to bank on Wilshire Boulevard in Los Angeles and purchased cashier's checks in amounts less than $10,000. We then returned to Miami and gave the checks to Mr. Behar.

Upon my return, I happened to read an article in a Miami newspaper which explained money laundering and how it was accomplished through multiple cashier's check purchases in amounts less than $10,000. I immediately knew that I had been an unknowing participant in this type of money laundering activity. That same day, I contacted agents of the Federal Bureau Investigation to inform them of this activity and thereafter met with agents of the Interal Revenue Service to detail this activity. At their request and after consultation with the United States Attorney's Office in Miami, I agreed to continue working for Mr. Behar on an undercover basis to facilitate a federal investigation. Thereafter I continued my check purchasing activity to Mr. Behar and his associates and reported my activities on a near daily basis to the federal agents.

In mid-May, 1985, Mr. Behar returned from Colombia and began to expand his money laundering business. For the next several months, I received amounts of up to $100,000 on a daily basis to convert into cashier's checks or money orders in amounts under $10,000. At some points, I began purchasing more money orders using the same multiple-bank procedures because money orders required no payee names. During this period, I became better acquainted with Mr. Behar's operation and the persons

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involved in that operation. I learned from Mr. Behar that his money suppliers in the United States were referred to him by "Alex" in Colombia. I also became acquainted with persons supplying money to Mr. Behar in the U.S. and personally picked up large sums of money from these persons. Ordinarily, this money was in small bill denominations ranging from five to one hundred dollars. Mr. Behar never commented on the source of this currency other than to jokingly say that the five and ten dollar bills were "marijuana money" and the larger bills were "cocaine money". This money would be delivered in large amounts to Mr. Behar's place of business inside duffle bags and other type of containers. Typically, Mr. Behar would give me $50,000 - $100,000 at a time which I would count, bundle and take to various banks to buy cashier's checks and money orders. I usually delivered these instruments to Mr. Behar in the afternoon and then assisted Mr. Behar in counting cash delivered to him that day. Mr. Behar wanted me to turn in no carbon copies or other records of the instruments I purchased. Mr. Behar had several other persons working for him in the same capacity as myself.

Throughout this period, I learned that Mr. Behar did three things with the checks and money orders we purchased. Most of these checks were picked up by courier from Mr. Behar's place of business and flown out of the United States by commercial airlines. Other checks were returned to the money suppliers in Miami and still other were deposited (with forged endorsements) into accounts at local banking institutions. I personally assisted in this distribution by driving couriers to the airport and by making deposits with Mr. Behar at various Miami banks.

In February, 1985, Mr. Behar and his associates were arrested and indicted on federal charges in Miami. I understand that Mr. Behar and several of his associates subsequently plead guilty to certain of these charges.

U.S. Department of Justice

United States Attorney
Southern District of Florida

155 South Miami Avenue, Suite 700
Miami Florida 33130

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April 30, 1986

The Honorable Fernand J. St. Germain, Chairman
Subcommittee on Financial Institutions Supervision,
Regulation and Insurance
Room 2128
Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

On April 16, 1986, I was honored to appear before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance to respond to inquiries of certain members of your Subcommittee relating to the mechanics of money laundering in the Miami area. During the course of the hearing, I was asked to respond in writing to the following questions:

(1) Why did certain banks in the Miami area increase the maximum amount for which money orders could be purchased from $2,000 to $10,000; and

(2) What "float" period do banks experience between the time of purchase of a cashier's check or money order and the date the bank is actually charged for these financial instruments (assuming they are purchased for international money laundering purposes)?

To answer these questions, I have consulted with Special Agent Allen B. Chase, an experienced criminal investigator with the Internal Revenue Service, who has made appropriate inquiry from banking personnel in the Miami area. Special Agent Chase has advised me that Amerifirst Federal Savings and Loan has increased the maximum amount for which a money order can be purchase to $10,000 in order to encourage the purchase of money orders over cashier's checks issued by that financial institution. Money orders are sold by Amerifirst but issued by the American Express Company which is ultimately responsible for these instruments should they be lost or stolen. By selling money orders in amounts up to $10,000, Amerifirst is able to avoid potential liability which previously required banks to experience paper work and the expense of indemnification bonds.

Special Agent Chase further advised that the "float" period enjoyed by banks on monetary instruments used to launder currency varies with the type of instrument purchased and the destination of the instrument itself. Typically, cashier's checks purchased by money launderers and sent to banks for collection outside the United States result in a "float" of two to four weeks depending on the location of the foreign bank and the efficiency of that bank in processing and collecting on these instruments. In some cases, however, this period is much longer due to a variety of reasons so that a float can extend for periods of up to six months. Money orders result in a much shorter float of only two to three days due to the bank's payment to American Express through domestic banking channels for the money orders sold by the bank for American Express. It should be noted that the float experienced by American Express on money orders is approximately the same as that experienced by the banks for cashier's checks.

I hope these responses are satisfactory and useful to the Subcommittee. I would be pleased to provided further information if necessary.

Sincerely,

LEON B. KELLNER
UNITED STATES ATTORNEY

BY: ____________________
TED E. BANDSTRA
ASSISTANT UNITED STATES ATTORNEY

STATEMENT OF

RICHARD C. WASSENAAR
INTERNAL REVENUE SERVICE
ASSISTANT COMMISSIONER (CRIMINAL INVESTIGATION)

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

ON THE
HEARING TO PROTECT AGAINST
FINANCIAL INSTITUTIONS BECOMING
HAVENS FOR TAX EVADERS, DRUG TRAFFICKERS
AND LAUNDERERS OF FUNDS DERIVED FROM
CRIMINAL ACTIVITY

APRIL 16, 1986

Introduction

Thank you for the opportunity to testify concerning the Internal Revenue Service efforts to use the laws within its jurisdiction to attack money laundering.

As the Assistant Commissioner (Criminal Investigation) for the Internal Revenue Service (IRS), I am the principal advisor to the Commissioner in the areas of planning, coordinating and evaluating IRS criminal investigative activity. Criminal Investigation has responsibility for the investigation of alleged violations of the Internal Revenue Laws and related offenses, certain aspects of 31 USC (Bank Secrecy Act) and the protection of Service personnel and property in appropriate situations.

We at the Internal Revenue Service believe that devoting substantial resources to the investigation of money laundering is appropriate not only because of the significant amount of revenue that can be collected but also because the Services's tax administration expertise can be focused on the motive for drug trafficking -- the huge illegal profits involved. In order to stem the flow of drugs we must attack the movement of funds generated by this illegal activity.

Money laundering is big business. It is also a business with varied clientele: drug dealers saddled with millions of dollars in cash per week; ostensibly legitimate businessmen trying to evade taxes; giant corporations setting up slush funds for bribes and kickbacks; and ordinary people trying to hide their assets.

We make every effort to investigate and prosecute those guilty of tax crimes. But when that is coupled with other, perhaps more sinister crimes against society, there is a clear-cut obligation on our part to combine our resources with those of other agencies to identify and prosecute the perpetrators.

Bank Secrecy Act

I would like to begin with a brief review of the Bank Secrecy Act in order to place our activities in perspective.

As a result of concerns expressed by law enforcement over the laundering of illegally generated proceeds through domestic banks and foreign tax havens, Congress passed the Bank Secrecy Act in 1970 (P.L. 91-508). The Act provided four basic tools to identify those who attempt to conceal their participation in crimes where substantial amounts of currency are generated, and to provide a basis to prosecute those who fail to comply with its requirements. The Act focuses on individuals involved in the flow of currency, as opposed to those involved in the substantive violations that generated the currency. Legislative history of the Act shows that Congress explicitly recognized the value of the Act to have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.

The four basic tools provided:

- A paper trail of records that must be maintained by financial institutions for up to 5 years. These records include copies of checks, drafts, money orders, and customer identification information.

- A Currency Transaction Report (CTR) that must be filed by banks and other financial institutions whenever a currency transaction over $10,000 occurs.

- A Currency or Monetary Instruments Report (CMIR) whenever currency or monetary instruments over $10,000 are taken into or out of the U.S. Offenses relating to the transportation of currency across U.S. borders are investigated by U.S. Customs.

- A Foreign Bank Account Report (FBAR) is required whenever a person has a financial interest in or signature authority over a foreign financial account in excess of $10,000 in value.

In addition, recent regulatory amendments added additional reporting requirements:

- Casinos with gross annual gaming revenue over $1,000,000 are added to the list of financial institutions that must file CTR's for currency transactions over $10,000.

- The Secretary of the Treasury may require certain financial institutions to report transactions with foreign financial agencies. These transactions include wire transfers, checks or drafts, loans, commercial paper, stocks, bonds, and certificates of deposit.

There are both civil and criminal penalties associated with violations of the Bank Secrecy Act. Civil violations can result in penalties of up to $10,000 per violation. Criminal penalties can result in a maximum prison term of up to five years and a fine of up to $250,000.

When the violation is committed in furtherance of the commission of any other violation of Federal law, or is committed as part of a pattern of illegal activity involving transactions exceeding $100,000 in any 12-month period, then the maximum fine is increased to $500,000.

The IRS has the responsibility to conduct Bank Secrecy Act criminal investigations of all banks and other financial institutions defined in Title 31. The IRS also conducts civil compliance examinations of secondary financial institutions. Secondary financial institutions include, but are not limited to, non-regulated banks, casinos, and currency exchange houses.

Bank Secrecy Act Report Processing

IRS also has responsibility for processing the CTR's, FBAR's, and casino reports which are required under the Bank Secrecy Act.

In October 1984, the Service centralized the processing of these forms at the Detroit Data Center. We moved the processing of the forms after a study indicated Detroit had the hardware necessary to establish a central data base, and was better able to accomplish our administrative and evidentiary needs. A special unit on Banking and Currency was established and is responsible for receiving and processing all CTRs, Casino CTRs, and FBARs.

The forms are reviewed and assigned a code number. The information on the forms is then entered into the central data base. Once the information is in the computer system it has several uses. Representatives of Criminal Investigation, with the assistance of computer generated data, analyze the information and provide field offices with leads to suspicious transactions. The Detroit Data Center also receives inquiries from the field to search electronically, for any CTR's or similar documents which individuals or financial institutions may have filed, or certify that none have been filed. In addition, correspondence is generated to filers of the documents if a critical element on a report is missing. Tapes containing the information are furnished to the Treasury Enforcement Communications System - TECS and to the IRS National Computer Center for our Information Returns Program.

Once the information is included in TECS it is available to the various regulatory agencies responsible for conoducting the Bank Secrecy Act compliance examinations at financial institutions. The IRS National Computer Center uses these reports as supplemental information in identifying tax returns that should be examined.

During recent months there has been a tremendous increase in the number of Currency Transaction Reports filed. The Bank of Boston pleaded guilty to Bank Secrecy Act violations and was sentenced in February 1985. After this sentencing, the national rate of CTR filings rose steadily from less than 70,000 a month to a high of 254,530 for December 1985, a fourfold increase. For 1985, the number of CTR's filed totalled 1,832,000, up from 700,000 CTR's in 1984.

In January 1986, the number of CTR's filed totalled 271,630. Based on this filing rate we anticipate that approximately three million CTR's will be filed during calendar year 1986.

Due to the increased volume, and in an effort to reduce time and costs, we are considering accepting electronic filing of CTRs. Many banks enter their CTR information into their own computer system and could provide reports directly to the IRS by magnetic tape instead of sending paper documents. Such a system would substantially cut our processing costs and processing time. I'm sure it would also result in lower processing costs for the banks. Some of the details that need to be worked out are computer compatibility, security of data transmitted, and adjustments to time periods for filing requirements. We will be working with Treasury and interested financial institutions on this matter.

Enforcement Efforts

The IRS has made substantial progress in its enforcement efforts. Since October 1981, we have initiated criminal investigations of more than 873 money laundering specialists, corrupt financial institutions, and their employees.

As of January 31, 1986, Criminal Investigation has over 300 Bank Secrecy Act investigations currently in open inventory. Over 60 of these are investigations of financial institutions. During 1985, we recommended prosecution of 317 cases involving money laundering.

We have presented evidence leading to the conviction of a total of 31 banks and financial institutions since 1981, with 8 convictions in the past year alone. These banks have been criminally fined nearly $4,000,000. In addition, we have presented evidence leading to the conviction of 34 officers or employees of financial institutions since 1984.

Examples of Bank Involvement

Money laundering specialists use a number of techniques to provide services for their clients. These range from cash transported offshore in suitcases, to elaborate unofficial banking operations, to the use of fictitious offshore entities.

I would like to describe some of the cases we have investigated, which involve complicity by the financial institutions used by the launderers.

Garfield Bank

In 1981, an undercover operation in Southern California focused on the laundering of narcotics money through a Los Angeles bank with the assistance of top bank officials.

Nathan Markowitz, a Los Angeles attorney, acted as a "money laundering specialist" who provided the service of disguising the source of profits earned by his clients, who were California narcotics traffickers.

Markowitz established nominee accounts at the Garfield Bank and sham corporations in the State of California. He also established foreign corporations in Panama and Liberia, and trusts at the Bank of Bermuda, where bank secrecy laws prevent law enforcement authorities from obtaining records. Large amounts of currency were deposited into various domestic accounts over which Markowitz maintained control. This money was then wire-transferred to trusts at the Bank of Bermuda or was used to purchase cashier's checks at the Garfield Bank for Markowitz's clients.

The key to the initial success of the laundering operation in this case was the complicity of bank officials who willingly and knowingly failed to file CTR's.

The president, and two vice-presidents, allegedly to increase the volume of business, arranged with Markowitz's to accept the cash deposits of Markowitz' narcotics trafficker clients. Although each deposit exceeded $10,000, CTRs were not filed. Over a 2-year period, Markowitz laundered a total of $3.3 million with the assistance of these bank officials.

The three Garfield Bank officials and three of Markowitz' associates were subsequently convicted of felony violations of the Bank Secrecy Act for their involvement in the failure to file CTPs for the money that was laundered through The Garfield Bank. The Garfield Bank was also convicted of Bank Secrecy Act violations and was fined $309,106, an amount equal to their net income for 1980.

Markowitz was murdered prior to trial. Los Angeles newspaper reports speculated that the murder was motivated by Markowitz' agreement to cooperate with the government.

Great American Bank

As a result of Operation Greenback, a Federal grand jury indicted the Great American Bank of Dade County, Florida and three employees, including the vice president of the installment loan department, a loan officer, and the head teller. The indictments, returned as a series from December 1982 through April 1984, charged that the bank laundered more than $94 million from January 1980 through February 1981, and willfully failed to file 406 CTRs during that period.

The money laundering schemes effected through this bank included agreements between the narcotics trafficking organizations and the vice-president of the Great American Bank, Lionel Paytuvi. The traffickers agreed to maintain large balances in their accounts, and the bank and certain personnel would receive a fee for processing and counting large currency deposits. The fee was divided equally between the bank, Paytuvi, and Carlos Nunez, a loan officer, who then divided his share with the head teller, Elaine Kemp. Carlos Nunez and the head teller also agreed not to file CTRs for deposits of currency in excess of $10,000. Nunez issued cashier's checks disguised as loan proceeds to the drug dealers, and processed their money through foreign and interstate accounts.

In addition, Isaac Kattan, a professional money launderer, was another valued bank customer, and used it to launder millions of dollars in narcotics proceeds.

Kattan's operation involved the cash deposits of large sums of narcotics proceeds by Kattan or his couriers into his "Currency Exchange Corporation" account, where it was transferred via cashier's check, wire transfer, or check to the Bank of Miami, where Kattan held an account in the name of "Sofisa." Great American Bank assisted in the money laundering scheme by routinely falsifying names of remitters on Kattan's cashier's checks, as well as failing to file the required CTR.

After a series of transactions through foreign tax havens, the U.S. funds would appear as assets of Kattan's Colombian travel agency, which was also a front for Kattan's Colombian black market money exchange. Kattan could then pay Colombian narcotics traffickers in Colombian pesos, as well as finance the transportation of narcotics from Colombia to the United States. In many instances, currency never left the United States because of Kattan's large source of pesos from his black market money exchange, which he acquired by transferring various U.S. bank checks rather than actual U.S. currency.

Kattan was convicted of CTR violations and sentenced to serve 5 years in prison.

Caribbean Federal Savings Bank of Puerto Rico

On June 6, 1985, in the largest operation of its kind, more than 200 Federal and local law enforcement officers arrested 17 individuals (14 present or former bank officials) and served 10 search warrants (9 on branches of several banks) on the island of Puerto Rico.

The warrants were the result of a two year investigation, code named TRACER, conducted by a joint Federal Financial Investigative Task Force known as Operation Greenback - Puerto Rico. The violations in support of the warrants included Title 31 and Title 18, of the United States Code, as they related to alleged illegal money laundering activities. Operation Greenback is a combined law enforcement effort drawing upon the resources of the Internal Revenue Service, Drug Enforcement Administration, United States Customs Service and attorneys from the United States Department of Justice.

One of the individuals arrested included the president of Caribbean Federal who, at the time, was on the Board of Directors of the Federal Home Loan Bank in New York, the agency having regulatory responsibility for savings and loan associations.

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During the course of this investigation, undercover agents laundered $335,000, through Caribbean Federal by purchasing bearer certificates of deposit with currency. However, the deposit tickets were prepared by bank officials falsely showing these cash purchases as check purchases. Currency transaction reports were neither filed nor prepared with regard to these transactions. The investigation also disclosed that other individuals who made purchases in this manner included members of Caribbean Federal's Board of Directors, professional gamblers and a high level drug dealer, who is presently serving a jail term in a Florida state penitentiary for drug violations.

Caribbean Federal pleaded guilty to three counts of having knowingly and willfully failed to file currency transaction reports in violation of the Bank Secrecy Act and was subsequently fined $450,000. Charges are still pending against the president of the bank. In all, Operation Tracer has resulted in fourteen convictions to date.

Botero

In January 1981, several Colombian nationals (known collectively as the Botero Organization) and U.S. citizens were charged with attempting to launder $57,000,000 in U.S. currency through the branch of a Fort Lauderdale bank in an 8-month period. It was alleged that this currency represented payments from domestic narcotics organizations to Colombian source suppliers for cocaine and marijuana smuggled into the United States and distributed through domestic trafficking organizations. This ultimate street value of the drugs would be over half a billion dollars. While this $57,000,000 represents the wholesalers receipts, it includes none of the profits reaped by the domestic organizations.

The Botero Organization enlisted the assistance of three bank officers at a small branch of a major Florida bank. Being paid a cash fee of 0.5 to 1.0% of the monies to be laundered, the officers opened numerous bank accounts in fictitious names with fictitious identification. The idea was to accept the cash deposits, run this cash through the bank accounts and file false currency transaction reports. The funds would then be wire transferred from the numerous accounts at the primary bank to a correspondent account of a foreign bank in Miami. From this second account the funds would be wire transferred offshore and distributed to other accounts in a foreign country. The U.S. dollars would then be available for a variety of uses, including sale on the black market for Colombian pesos or simply to secure wealth in U.S. dollar denominated instruments.

The currency deposited into this small branch bank in Fort Lauderdale was a contributing factor to the enormous surplus of currency at the Miami branch of the Federal Reserve. During the late 1970's this surplus in the amount of currency from Southern Florida financial institutions led us to believe that lucrative criminal activities were the source of these funds.

After the indictments in this case were returned, Herman Botero, a prominent Colombian businessman and owner of the national soccer team, fled the U.S. Botero became the first Colombian national ordered extradited to the United States by the Supreme Court of Colombia. He was convicted in 1985 and sentenced to serve 30 years in prison.

Although Botero and his associates were successfully prosecuted, most of the $57 million was transferred out of the country and the remainder distributed throughout the United States. We have no authority to seize and forfeit the funds. This case points to the need for legal authority to seize and forfeit currency (and property traceable to such currency) involved in CTR violations.

We have some concern that professional money launderers or narcotics traffickers may attempt to gain financial control of financial institutions to facilitate their money laundering activities. The Drug Enforcement Administration was successful in recent prosecutions of a drug ring in which the leader, Jose Antonio Fernandez, owned a controlling interest in the Sunshine State Bank in Miami, Florida.

We are alert for such situations, and are currently conducting several investigations in which individuals involved in criminal activity may have an ownership interest in a financial institution.

I do not want to leave you with the impression that all money laundering through banks and financial institutions is accomplished with the complicity of the institution. In fact, most of the schemes we investigate include money launderers who have gone to great lengths to prevent the financial institutions from being aware they are moving a large amount of currency through the institutions.

Multiple Transactions and the Need for Regulatory Change

While we have been quite successful in prosecuting banks for willful violations of the Bank Secrecy Act, we have been considerably less successful in prosecuting bank customers who deliberately prevent the institution from filing a CTR. A great concern of late in enforcing the Act is the problem of customers structuring currency transactions into increments of less than $10,000 in order to prevent the financial institution from filing a CTR. Financial institutions must file a CTR with the IRS for currency transactions over $10,000. A person who wishes to transact a large amount of currency at a financial institution for deposit into an account, wire transfer offshore, or to purchase monetary instruments, will often hire one or more individuals (we call them "smurfs") to scurry from bank to bank with increments of less than $10,000 in order to assure that no CTRs are filed. Through these multiple transactions, the money launderer is able to defeat the purpose of the Bank Secrecy Act. We are deprived of CTRs that would be of great value in investigating and prosecuting individuals involved in illegal drug trafficking and tax crimes.

The person who engages in the multiple transactions and thereby causes the CTR not to be filed is not guilty of illegal conduct in many situations. The 1st, 9th, and the 11th circuits have recently indicated that smurfing, at least if conducted at different banks on the same day, or at the same bank on different days, is not a crime. See United States v. Anzalone, 766 F.2d 676 (1st Cir. 1985) (reh. den.); United States v. Varbel, et al. No.

84-1231 _slip_ op. (9th Cir., Jan. 10, 1986); _United States v. Denemark,_ No. 85-3554, _slip op_. (11th Cir., Jan. 16, 1986). As a result, the government needs to make the program effective. Smurfing becomes a legal way to defeat the purpose of the law, i.e., the detection of illegal activity and tax evasion.

The principle legal difficulties of prosecuting a smurf or the person for whom he acts, are caused by two aspects of the current Title 31 regulations. First, the CTR filing duties are placed solely upon the financial institution (31 CFR Section 103.22). Therefore, only a financial institution can directly violate the reporting requirements. A money launderer, in his capacity as a customer, has no reporting duties other than providing proper identification upon request. Unless the transaction exceeds $10,000, the financial institution will not request identification from the customer, and the customer will not have occasion to misrepresent his/her identification.

For example, the 9th Circuit Court of Appeals in _Varbel_, when faced with the district court's conviction of a customer who took $50,000 of currency and purchased six cashier's checks in amounts less than $10,000 at six different banks on 3 different days, pointed out the following:

> "The Secretary's implementing regulations require only financial institutions to file currency transaction reports and then, only when they participate in currency transactions involving more than $10,000. ...The Secretary could have required participants other than financial institutions to file a report; however, 31 CFR Section 103.22 limits the reporting requirement to financial institutions _only_. ... We conclude that the reporting act and its regulations did not impose a duty on appellants to inform the banks involved of the nature of their currency transactions. We believe that the application of criminal sanctions against appellants here would violate due process."

The second aspect of the regulations causing prosecution difficulties is the lack of any requirement that multiple currency transactions on the same day (each less than $10,000) that _aggregate_ more than $10,000, be reported by a financial institution. Although the CTR Form 4789 requires aggregation of multiple transactions at the same financial institution on the same day, some courts have refused to enforce such language on the grounds that the form alone does not provide constitutionally sufficient notice. _United States v. Cogswell_, No CR-85-646, Northern District of California (1985). Regardless, the language on the form is presently inadequate because it fails to cover transactions occurring at different financial institutions. One of the most common methods of smurfing is the practice of traveling to different banks on the same day with increments of less than $10,000 in order to prevent a CTR from being filed.

In Denemark (supra), the lack of any regulatory requirement that a financial institution aggregate transactions occurring at other institutions on the same day caused the 11th Circuit Court of Appeals to reverse the conviction of a bank customer. Denemark split up $137,000 of currency into increments of less than $10,000 and purchased 14 cashiers checks at 14 different banks on the same day. The appellate court reasoned that "there was no transaction in a financial institution which would require any such institution to file a CTR."

Denemark was charged with violations of 18 U.S.C. Section 2 (aiding and abetting or causing another to commit an offense) and Section 1001 (concealing from the government a material fact by a trick, scheme, or device). The court stated that Denemark should not have been prosecuted for causing the financial institution to fail to perform an act (filing a CTR) which the financial institution had no legal obligation to perform.

Treasury, with input from the Internal Revenue Service and the Justice Department, is currently in the process of preparing regulations to address these and other aspects of the Title 31 regulations. The Title 31 regulations must at least be clarified to impose a clear duty upon financial institutions to aggregate multiple transactions occurring on the same day that the institution is aware of. In addition, some sort of reporting duty should be imposed upon customers in order to obtain CTRs for transactions in which the financial institution would not normally be aware that more than $10,000 of currency had been transferred within a 24-hour period. For example, situations such as Denemark, in which a person travels to 14 different banks on the same day. No one bank will likely know about the transfers at the other banks unless the customer tells the institution.

A clear reporting duty on the customer will also overcome the concern expressed in Varbel (supra), that "the reporting act and its regulations did not impose a duty on [customers] to inform the banks involved of the nature of their currency transactions."

Offshore Money Laundering and Foreign Evidence Problems: The Role of Banks

In recent years both the legal and illegal use of tax havens by United States companies and individuals has increased. Tax haven jurisdictions are uniquely suited to facilitate illegal conduct, such as tax evasion and the hiding of income from criminal activity. Tax haven jurisdictions encourage offshore transactions through the promotion of the following:

(1) The low tax rate, if any, which eliminates concern about the funds being subject to tax by the haven;

(2) the presence of banks and other financial institutions which proliferate in tax haven countries and provide the facilities to move or hold funds;

(3) the presence of a professional community including bankers, lawyers, and accountants to provide financial advice and financial services such as setting up dummy corporations, documenting questionable transactions, and providing general financial advice;

(4) the bank secrecy and blocking laws protecting against detection of illegal schemes by law enforcement agencies including the Internal Reenue Service.

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(5) nonrecognition of tax evasion as a crime, resulting in the refusal of assistance in investigations of suspected tax evaders;

Willingly or unwillingly, banks, both in the United States and the haven country, are vital components in the entire offshore money laundering scheme. Banks have the physical facilities to accept large amounts of cash, issue checks, make loans, and receive or send funds by wire. The funds are secure and may even earn interest.

A compelling illustration of the critical role of banks in offshore money laundering schemes was provided by a Los Angeles attorney/money launderer who explained the ease of the process to a government undercover agent:

> "...You're going to take it out of your right hand pocket and pay it back into your left hand pocket..Which I think is a beautiful way to use your money...You haven't transported money out of the United states which is a crime, you haven't taken the risk of carrying it, and it's done on a bank to bank basis. Within 48 to 72 hours, I can move the money from Los Angeles to Bangkok or Istanbul or Afghanistan or wherever you want it...And you see, if Uncle then looks at you and says, "Where did

> you get this money from,' well (you say), "I borrowed the money from such and such corporation which is an offshore corporation' and they're in the money lending business...you see, for 20 to 22 thousand bucks, you got yourself a totally confidential setup."

Absent treaties, or other bilateral agreements, it is extremely difficult for the IRS to obtain the production of records from banks located in financial secrecy jurisdictions. Conventional investigative tools, such as the summons or subpoena, are useless unless a U.S. Court can acquire personal jurisdiction over the bank and enforce compliance. We have achieved success in those cases where the foreign bank has a branch office in the United States, or where a United States bank's foreign branch is involved.

Our experience with the Bank of Nova Scotia underscores the difficulties that we encounter in obtaining evidence from tax haven banks even when there is a domestic branch. United States v. Bank of Nova Scotia, 691 F.2d 1384 (11th Cir. 1982) and United States v. Bank of Nova Scotia 740 F. 2d 817 (11th Cir. 1984). Although we ultimately won both cases, the process of obtaining the information was costly and time consuming.

1982 Bank of Nova Scotia Decision - The Bank of Nova Scotia is a Canadian chartered bank with branches and agencies in 45 countries, including the United States and the Bahamas. A Federal Grand Jury conducting a tax and narcotics investigation issued a subpoena duces tecum to the Bank calling for the production of certain records maintained at the Bank's main branch or any of its branch offices in Nassau, Bahamas and Antigua, Lesser Antilles, relating to the bank accounts of a customer of the Bank. The subpoena was served on the Bank's Miami, Florida agency on September 23, 1981. The Bank declined to produce the documents asserting that compliance with the subpoena without the customer's consent or an order of the Bahamian courts would violate Bahamian bank secrecy laws.

After the district court entered an order compelling the Bank to comply with the subpoena, the Bank's Miami agent appeared before the grand jury and formally declined to produce the documents called for by the subpoena. The district court held the Bank in civil contempt and that order was upheld on appeal on the grounds that the importance of the U.S. grand jury criminal investigative function outweighed the Bahamas' interest in protecting privacy through bank secrecy.

1984 Bank of Nova Scotia Decision - The bank again moved to quash a grand jury subpoena served on March 4, 1983, and was again held in contempt and the contempt sanction of $25,000 per day (until the bank complied with the subpoena) was sustained on appeal.

The appellate court agreed with the district court that the bank failed to exercise good faith in complying with the subpoena: "On October 20, 1983, 7 months after the grand jury subpoena had been served, the only document produced by the Bank was a Xerox copy of a draft..."

In November of 1983, after the Bank insisted that they diligently searched all ten branches in the Bahamas and had produced all documents, the IRS special agent warned Bank's counsel that more documents sought by the subpoena had not been produced. Thereafter, in December of 1983, the Bank produced photocopies of voluminous records from 1979. The remaining documents were finally produced on January 25, 1984, almost a year after the subpoena was served.
The Bank of Nova Scotia was fined $1,825,000.

The Gucci Investigation - Our successful prosecution of Aldo Gucci demonstrates the results that can be achieved when we are able to pierce the foreign bank secrecy laws. The case also shows that bank secrecy is used as a shield by ordinary tax evaders, not just organized criminals laundering drug money. Again, we could reach the foreign bank records only because branches of United States banks (Chase Manhattan and Citibank) were involved.

Gucci used Hong Kong sham corporations, Garpeg Ltd. and FDC Co. Ltd., as conduits for funds diverted to himself and others. When the IRS served summonses on Chase Manhattan and Citibank for the production of records relating to accounts maintained by Garpeg at the Hong Kong branches, Garpeg and the banks all resisted compliance with the summonses. The banks were ordered by the U.S. District Court to produce the records on the grounds that the vital interest of the United States in the enforcement of its tax laws outweighed Hong Kong's interest in maintaining confidentiality of banking records. Although the banks initially refused to follow the District Court order in light of an order from the High Court of Hong Kong enjoining the banks from producing Gucci records, the banks eventually complied when Gucci consented to production of the Hong Kong records.

On January 17, 1986, Aldo Gucci pleaded guilty to criminal tax violations on $11,881,022 of income diverted from Gucci's businesses during the 6 years 1977 through 1982. The additional tax liability is $7,392,512 not counting civil penalties and interest.

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We certainly applaud the results of the *Bank of Nova Scotia* and the *Gucci* cases; however, summonses and subpoenas are an ineffective means of obtaining bank records located outside the United States unless the records are in the custody of a foreign branch of a U.S. bank (Gucci) or a foreign bank having a U.S. branch (Bank of Nova Scotia). Cooperation from the government of the tax haven/secrecy jurisdiction, in the form of treaties or other bilateral agreements, is the best way to reach the records of foreign banks that do not have a U.S. branch. Such agreements can also reduce the enormous expenditure of time and resources needed to enforce subpoenas and summonses.

Fraudulent Tax Shelters

Financial secrecy jurisdictions are not only havens for money launderers and individual tax evaders. The privacy, efficiency, and security of the international financial network has also proved useful for fraudulent tax shelter promoters. Of the 406 cases involving abusive tax shelters currently under investigation by Criminal Investigation, over 50 percent involve tax haven countries.

An example is the investigation of the United States Tax Planning Service, Ltd. (USTPS). Affidavits for search warrants regarding USTPS were filed during May of 1984 throughout the United States. USTPS was created in the Cayman Islands by several individuals. The bank secrecy laws of the Cayman Islands were

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used to facilitate the concealment of the true nature of financial transactions. The scheme was designed to primarily appeal to physicians and other highly educated and wealthy individuals, by generating phony tax deductions.

An integral part of the overall scheme was the establishment of client-controlled foreign corporations concurrent with the establishment of offshore bank accounts. The USTPS scheme also involved the establishment of client-controlled offshore trusts; the creation of commodity straddles with offshore foreign involvement; the creation of transactions appearing to be loans and/or other non-taxable sources of income from the Cayman Islands; the use of bogus churches for phony charitable contribution tax deductions; and the creation of fictitious liability insurance, particularly Medical Malpractice Insurance, to permit tax deductions for apparently legitimate insurance premiums. Central to all of these schemes was a return to the investor of approximately 92 percent of the alleged deduction.

The promoters who conceived the scheme charged a fee of 8 percent for their services. USTPS promoters had substantial expertise in monetary and tax matters and knew how to best use financial institutions in furtherance of their fraud. In fact one promoter, who pleaded guilty to criminal tax charges, was the

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former Regional Counsel for the Southeast Region for the Comptroller of the Currency.

There is at least one known instance where USTPS promoters provided money laundering services to a U.S. citizen involved in the banking industry. The individual who wanted the money laundered owned and controlled several federally insured banks in Kentucky and Tennessee. The bank owner arranged for over $2 million in loans to be made by his banks to corporations controlled by himself and conspirators in the scheme. There was no intention to ever repay the loans. To ensure that the money would not be traced to him, the bank owner made arrangements with USTPS promoters to have the money moved to offshore accounts, converted to silver coin and returned to him in the United States.

In another scheme, unrelated to USTPS, but similar in basic concept, a very large domestic bank was defrauded of a substantial sum of money during operation of one of the sham transactions.

As a final example, during a current investigation being conducted jointly with the FBI, a scheme was uncovered that combines what appear to be abusive tax shelters with a form of bank raiding. "Bank raiding" refers in general to the practice of gaining control of a bank and then draining its assets through phoney transactions. Because it is an on-going investigation, I

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am not able to discuss the details of the case. However, I can say that the tax benefits alone are estimated to exceed one billion dollars. This scheme, in my opinion, represents the most material and pervasive threat by promoters of abusive tax shelters to date against United States financial institutions. Accordingly, we are coordinating our efforts closely with appropriate Federal financial regulatory agencies all of which are jeopardized to various degrees by this scheme.

Conclusion

In the last decade traditional financial institutions have become vital, albeit often unwitting, participants in all sorts of illegal activities. The international banking network offers the efficiency, security, and most of all privacy, cherished by criminals who specialize in money laundering, tax evasion, and other financial crimes.

These criminals have learned how to make the maximum use of international banking services. Funds are wire transferred out of the United States and then sent on a Caribbean Island hopping tour from one haven bank to another in order to cover the trail. The final foreign destination is often a traditional European financial center from which the funds can be repatriated with an added appearance of legitimacy.

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Money laundering is not just a problem for law enforcement. The illicit money circulating through the financial bloodstream of our country is a poison that attacks the health of the financial community itself. The good reputation of financial institutions who are found to have laundered illicit funds can be deeply scarred in the eyes of the public even if none of the officers or employees are culpable. Moreover, we are seeing cases in which banks are actually the prey of the white collar criminal. A solution to the money laundering problem will take the joint effort of government and the financial community. We must commit ourselves to make sacrifices and pursue with vigor those who would disrupt the free flow of commerce to facilitate their corrupting criminal activities.

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2 Executives Charged In Tax Fraud Scheme

United Press International

NEW YORK, April 2—A 74-year-old garment industry executive and his son-in-law today were charged in federal court with running a "false invoice" scheme to hide some $150 million in income tax earned by 170 companies and individuals.

Among the companies were a major retail chain and a publicly held company, which were not named.

The men were also charged with currency violations for distributing sums of currency in excess of $10,000 without filing Currency Transaction Reports as required by law.

Schnejer Zalman Gurary, 74, and Nochum Sternberg, 42, face up to 20 years in prison and fines of $750,000, said U.S. Attorney Rudolph Giuliani.

Giuliani said the men set up a group of 37 companies, known as the "Zalga" companies, received from 1979 to 1985 more than $150 million from at least 170 companies and individuals, took a 5 to 15 percent "fee" from them and then, using "false invoices," returned most of the money in cash and bonds.

They allegedly deposited at least $30 million in Swiss bank accounts.

The Zalga companies were rapidly formed and dissolved in an attempt to cover up their illegal operations, Giuliani said.

Paul Summit, an assistant U.S. attorney prosecuting the case, explained that a Zalga company would take checks from a "purchasing company" reflecting the supposed sale of goods by the Zalga company through "false invoices." The Zalga company then would return money to the "purchasing company" after taking out the fee.

"The purchasing company obtained two illegal benefits from the transaction," Summit said. "First, the principals of the 'purchasing company' received cash secretly, which enabled them to evade personal income tax; and, second, the 'purchasing company' claimed a false business deduction (based on the false invoice) on its corporate tax return."

The publicly held company allegedly engaged in more than $15 million worth of transactions.

Garment center businessman Irwin Feiner pleaded guilty Oct. 24 to charges of conspiracy, tax evasion and wire fraud.

The complaint against Gurary and Sternberg says Feiner and his company engaged in more than 700 false invoice transactions as a purchasing company. His company allegedly paid more than $25.6 million and received back more than $24.3 million in cash and bonds.

Gurary and Sternberg generally brought the cash in a satchel, it was alleged. Feiner had said that, when the satchel was open and the cash—in the thousands of dollars—he was to receive was taken out, he could see it was only a thin layer of the cash in the satchel.

Money Laundering

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Ex-Banker Sentenced In Drug Scheme

By Nancy Lewis
Washington Post Staff Writer

A former Riggs National Bank vice president was sentenced yesterday to six months in prison, fined $10,000 and ordered to perform 1,000 hours of community service by a federal district judge here who said the penalties should "send a message" to bank officials who launder drug profits.

"This needs to be stopped," said U.S. District Judge Thomas F. Hogan as he sentenced William G. Hessler, 48, who pleaded guilty last month to not reporting to the Internal Revenue Service a $450,000 cash deposit that prosecutors said represented the proceeds of a cocaine distribution ring that smuggled the drug from Columbia and sold it in the United States.

Hogan, who told Hessler that he would have imposed the maximum sentence of five years in prison and a $500,000 fine if he thought that the former manager of Riggs Watergate branch knowingly had laundered the money, called the banking industry the "crucial" link in allowing drug dealers to channel their profits into legitimate business.

"Didn't it cause you any concern" when former Washington lobbvist Fred B. Black Jr. showed up at the bank with nearly $500,000 in cash crammed in a shopping bag, Hogan asked Hessler.

"No, sir," Hessler replied. Hogan then said that he was "surprised by some of the things that went on at the bank."

U.S. Attorney Joseph E. diGenova said prosecutors were "very pleased, very satisfied" with the sentence imposed on Hessler, of 11832 Dinwiddie Dr., Rockville, who resigned from the bank in June 1983, three weeks before he was indicted in connection with the drug ring, which prosecutors said was led by his brother-in-law, Lawrence G. Strickland Jr.

"The signal sent, obviously, is that bank officials, who can be the first line of defense in the community against money laundering by international drug dealers, can be held accountable," diGenova said.

Hessler is the 14th person convicted in the case, which is the first brought here as a result of an investigation by the Organized Crime Drug Enforcement Task Force formed by the Reagan administration in 1982. At his trial in June, Hessler was acquitted of six charges of misusing bank funds, mail fraud and failure to report taxable income, but the jury could not reach a verdict on 17 other counts.

In the same trial, Black, 71, was convicted of three counts of income tax evasion and, in a separate trial, was convicted with three other defendants, of conspiracy to import and distribute cocaine. He is serving a seven-year prison term.

Assistant U.S. Attorney Roger Adelman told Hogan that Hessler is different from the others in the case because he "occupied in his career a position of trust." Despite Hessler's guilty plea, Adelman said, Hessler "perpetuates the myth" that he has done nothing wrong.

According to testimony during the trial, at the time that Hessler extended unauthorized bank loans to Black, he borrowed $40,000 from Black to help buy the house in which Hessler lives. Prosecutors alleged the money was a bribe; Hessler said it was a loan.

A financial statement filed in court indicated that Hessler does not expect to repay the $35,000 loan balance because the money was used to pay legal expenses "caused by Black and Strickland."

Edgar Wilhite, Hessler's lawyer, said his client was "strung along" by Black, whom Hessler said he considered "almost as a father to me," and that no one at Riggs knew much about the cash transaction laws.

Hessler told Hogan: "I still deny the charge concerning this case."

As a result of the case, Hessler said, "Now I'm a self-employed, blue-collar laborer . . . . My direct family is close to financial ruin."

Hogan imposed a three-year jail term, suspending all but six months, and ordered Hessler to work 500 hours in sports programs for poor and handicapped children and to spend 500 hours raising money for the American Cancer Society.

Money Laundering

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5 Held in Scheme for Laundering Millions of Dollars in Drug Profits

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By JUDITH CUMMINGS

Special to The New York Times

LOS ANGELES, Feb. 10 — Government agents have arrested five people suspected of involvement in laundering money in connection with a multimillion-dollar drug trade centered in Los Angeles and Miami, Federal prosecutors said today.

According to Robert C. Bonner, the United States Attorney in Los Angeles, and Leon B. Kellner, the United States Attorney in Miami, Federal agents since last September have seized 254 pounds of cocaine and $11.6 million in cash in connection with the case. Mr. Bonner said the cash was the largest amount ever seized "in a single coordinated drug case."

The five men include three Venezuelan nationals arrested in Miami Friday, another Venezuelan arrested in Los Angeles the same day and a fifth man, described as a Uruguayan, who was picked up in New York City.

They have been charged with conspiracy in connection with violations of Federal laws on currency reporting and disguising the sources of money.

Agents Posed as Intermediaries

Prosecutors described the operation as a "nationwide money-laundering service," saying the suspects tried to manipulate deposits of currency and electronic transfers of money for "major narcotics traffickers" dealing in large quantities of cocaine mainly in Florida and California.

In the investigation Federal undercover agents, working secretly with two commercial banks, one in Los Angeles and the other in Miami, posed as American intermediaries having connections with American bankers they said were willing to violate currency reporting requirements, according to documents filed in the case.

From the financial institutions that cooperated in the case, the money was transferred to bank accounts in Panama as well as to banks in Miami and New York, the documents say.

The documents say that the suspects made payments to the undercover agents to prevent reports of large currency transactions from being filed. But, according to the documents, the cooperating American institutions filed reports on the cash deposits.

Financial institutions are required by law to report any cash transaction of $10,000 or more to the Treasury Department. The transactions intercepted by the undercover agents ranged from $103,350 to more than $1 million in a single transaction, the Government said.

Since last September, 23 such currency transactions were conducted through the cooperating bank in California alone, the documents said.

Those arrested were identified as Carlos Sarmiento-Arechederra and Roberto del Pino Sousa, who were arrested in Miami and who the investigators say headed the nationwide operation; Oswaldo Vera, also arrested in Miami; Enrique Fernández, arrested in Los Angeles, and Luis Morales, the man arrested in New York. The latter three are described as employees or couriers.

The case was handled as a joint project by the United States Customs Service, the Internal Revenue Service and Federal prosecutors in Miami and Los Angeles.

Foreign Traffickers Get Profits

According to an affidavit by Lorraine Brown, a special agent with the Customs Service, the Sarmiento organization "moves millions of dollars in United States currency outside the country for the purpose of moving drug profits back into the hands of drug traffickers outside the United States."

She said Mr. Sarmiento and his collaborator, Mr. del Pino, operating from both Venezuela and Colombia, had employed Mr. Vera and Mr. Fernandez as their representatives in Los Angeles to receive from Los Angeles drug traffickers the cash that was to be laundered.

A Customs Service special agent, Awilda Villafane of Miami, an undercover agent in the case, reported that Mr. Sarmiento offered undercover agents commissions of from 1.5 percent to 2.5 percent of cash transactions for help in circumventing reporting laws.

He said the suspects kept financial records coded with "computer numerals" to disguise the identities of clients and associates.

The financial institutions that cooperated in the case were not identified.

Money Laundering

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(A16)

McLean Bank Admits Failing to File Reports on Cash in Major Drug Case

By Elizabeth Tucker
Washington Post Staff Writer

McLean Bank pleaded guilty yesterday to charges that it failed to tell the Internal Revenue Service about sizable cash transactions that helped drug ringleader Christopher F. Reckmeyer launder millions of dollars from illegal drug sales.

The bank, but not bank officials, pleaded guilty in U.S. District Court in Alexandria to intentionally failing to file reports on 23 occasions between July 16, 1980, and April 27, 1981. The cash involved totaled $620,000—part of more than $2.25 million deposited at the bank in an account controlled by Reckmeyer beginning in the 1970s, according to a statement by the office of the U.S. attorney for the Eastern District of Virginia.

Financial institutions are required by federal law to tell the IRS about cash transactions exceeding $10,000. The IRS uses the information for criminal investigations.

In January, federal prosecutors issued a 122-page indictment of Virginia brothers Christopher and Robert Reckmeyer and 24 others, alleging that from a few marijuana sales in 1972 at Langley High School in McLean, the Reckmeyers built a marijuana and hashish empire that stretched from coast to coast and grossed more than $100 million over a decade.

On May 17, Christopher Reckmeyer was sentenced to serve 17 years in federal prison after pleading guilty to masterminding the drug ring. Robert Reckmeyer was sentenced to 14 years in prison.

McLean Bank's guilty plea followed a grand jury investigation conducted by Assistant U.S. Attorney Kent S. Robinson during the last six months. The Drug Enforcement Administration, the Internal Revenue Service and U.S. Customs also worked on the case. Sentencing is set for Jan. 24 before U.S. District Judge James C. Cacheris.

Although the maximum penalty for the bank's violation is a $500,000 fine, terms of an agreement between the government and the bank limit the possible fine to $100,000.

Bank officials were not available for comment yesterday, but an unsigned statement was issued by the bank.

"The United States has concluded that no individual director, officer or employe of the bank has committed any criminal violation of the currency reporting requirements of the U.S. Code," the bank's statement said.

"Instead, the government's prosecution is based on the novel legal theory that the bank can be criminally liable for 'knowingly and willfully' failing to file currency transaction reports based on the 'collective knowledge' of its employes—in effect that some employes of the bank were aware of the bank's obligation to file such reports, but different employes were aware of the particular currency transactions.

"The bank has decided not to contest the government's interpretation of the law so that this matter, which involves transactions that are five years old, can be put to rest," the bank said.

Bank President Roy L. Browning was on vacation and not available for comment, according to a bank secretary. One bank employe said the problem was due to "lack of communication . . . . It has nothing to do with anything . . . underhanded."

Assistant U.S. Attorney Robinson said the charge was not based on a "novel" legal theory.

"The bank is saying people in management knew that currency transaction reports were supposed to be filed," he said. "The tellers who actually received the cash deposits were aware of the transactions

See McLEAN, D8, Col. 1

McLean Bank Admits Failing to File Reports

McLEAN, From D1

that gave rise to the need to file. Those two groups of employes never quite hooked up—that's the bank's claim.

"There is going to be a sentencing in this case, at which point both the bank and government will be able to say more about their position in this case," Robinson said.

Robinson said his office has investigated other banks and found "no indication that any other banks that the Reckmeyers were using failed to file currency transaction reports." The Reckmeyers used "several banks throughout Northern Virginia," he said, without identifying the banks. "Certainly any other cases of this sort which come to our attention will be vigorously prosecuted," he said.

Documents filed with the court disclose details of the cash transactions. Since the early 1970s, more than $2.25 million in cash was deposited on 173 separate occasions in an account called Crancy's Inc. and controlled by Christopher Reckmeyer, Robinson said. Beginning in 1978, many of the cash deposits exceeded $10,000.

But the McLean Bank filed only six reports to the IRS on the Crancy's account, involving about $200,000 in deposits, the U.S. attorney's office said. No reports were filed on 61 transactions involving more than $1.5 million.

Forty of the 61 transactions occurred before July 7, 1980, when the Federal Deposit Insurance Corp. put into effect new regulations concerning the filing of transaction reports, said Robinson.

Up until that date, it is "arguable" whether the bank was required to submit reports, he said.

McLean, a federally insured and state-chartered commercial bank, is in the process of being acquired by James Madison Ltd.

In 1984, in a case that indirectly involved McLean Bank, a federal bankruptcy judge in Alexandria appointed a trustee to manage the affairs of the Port Royal Development Corp. after witnesses brought by Mount Vernon Savings & Loan Association testified that the development company had mismanaged accounts for the Port Royal Condominiums on North Pitt Street in Alexandria.

The bank, but not bank officials, pleaded guilty in U.S. District Court in Alexandria.

Testimony at the bankruptcy hearing from a certified pubic accountant revealed that more than $50,000 in earnest-money deposits from persons with contracts to buy condominium units at Port Royal had been deposited in a savings account at the McLean Bank, instead of in escrow accounts as required by Virginia law.

At that time, documents showed that less than $10 remained in that account on Dec. 31, 1983, and that withdrawals had been made to finance other developments directed by Port Royal's principal officers, Eugene Lawson and Charles H. Schools. Schools, who had been chairman of the board for the McLean Bank until shortly before the controversy surfaced, was replaced by Roy L. Browning, but no one had been willing to say at the time why the change had been made.

Now, Browning is president, and the chairman is John G. Broumas, according to a bank employe.

In 1974, McLean Bank nearly collapsed under the weight of a wine investment scandal that touched its two top officers, bank officials said at the time. About $2.5 million in loans had been made to investors in the venture, which subsequently collapsed, leaving the young bank with a potential loss of $1.8 million.

The chairman, J. Michael Burry, was an investor in the scheme, which the Securities and Exchange Commission was to describe as fraudulent. Only the overnight infusion of $600,00C in cash by an investors group saved the Northern Virginia bank from having to be liquidated or merged with a holding company.

The bank's president, Walter P. Johnson, was removed from office for approving the wine loans and was indicted in 1977. He pleaded guilty to embezzlement and misuse of bank funds and was sentenced to six months in federal prison.

MONEY LAUNDERING-
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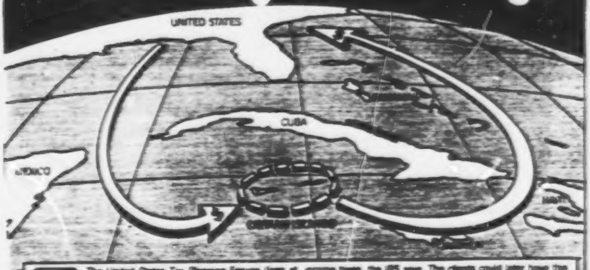
MOVING MONEY THROUGH THE CAYMAN ISLANDS



The United States Tax Planning Service (logo at left) offered a variety of ways for Americans to move their money through the Cayman Islands, according to Internal Revenue Service documents. The company's promoters suggested that the money be put into Cayman corporations or offshore insurance companies so that American clients could avoid paying income taxes, the IRS says. The clients could later have the money brought back into the United States in the form of loans, gifts, credit card accounts or other disguised means, according to the IRS.

Federal authorities estimate that up to $10 billion a year in illicit U.S. funds is laundered through banks in the tiny British colony.

IRS official Richard Wassenaar is probing illegal tax-evasion plans.

Money Laundering

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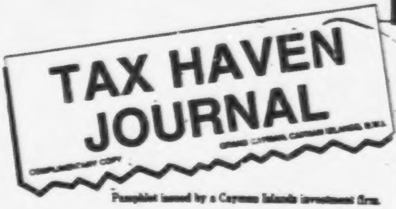

TAX HAVEN
JOURNAL

GRAND CAYMAN, CAYMAN ISLANDS, B.W.I.

COMPLIMENTARY COPY

Pamphlet issued by a Cayman Islands investment firm.

The Offshore Laundry

IRS Putting Promoters Through Wringer

By Howard Kurtz
Washington Post Staff Writer

Robert L. Schwind and David L. Hill carefully counted the cash that had been dumped on the bed in Room 1532 of Atlanta's Ritz-Carlton Hotel.

It was all there: $100,000 to be laundered through a dummy company in the Cayman Islands, and $16,000 for their fee. Hill said his hands often turned black from counting money, but that this cash was unusually clean.

The Atlanta attorneys placed the money in a laundry bag and gave their two clients a receipt. "There's no use in paying taxes," Hill told them. "That's what you're setting up these things for, so you can get around paying taxes on the transactions."

What Schwind and Hill didn't know is that their April 11, 1984, meeting was secretly recorded by their clients, who were working under cover for the Internal Revenue Service. Nor did they suspect that they were targets of the largest fraudulent-tax-shelter investigation in IRS history.

Schwind and Hill were working with the United States Tax Planning Service (USTPS), a mass-marketing operation that officials describe as the McDonald's of the illegal tax shelter business. According to IRS affidavits filed in court, USTPS sold exclusive franchise

See SHELTER, A10, Col. 1

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SHELTER, From A1

rights to American promoters, offered an innovative menu of tax avoidance schemes and attracted lots of customers.

One popular plan involved bogus medical malpractice insurance, in which doctors would take big tax deductions for their "premiums" and secretly get most of the money back, according to the documents. Another called for the client to buy phony consulting studies, again recouping most of the money after deducting the cost, the documents say.

Most IRS investigations involve a single promoter, but this money-laundering probe has attempted to track a loose network of about 20 USTPS associates from Massachusetts to California. The 22-month inquiry has involved more than 20 IRS officials in 10 cities.

This account was pieced together from hundreds of pages of IRS documents filed in various courts and made available by the agency, as well as interviews with IRS officials, shelter promoters, prosecutors and lawyers in the case.

In recent months, Schwind and Hill have pleaded guilty to tax fraud conspiracy, and a USTPS associate in South Carolina has been barred from peddling the tax shelters. More charges are expected.

Prosecution of Investors Planned

In a major break with past policy, IRS officials say they plan to prosecute not only the promoters but some of those who invested with USTPS. The agency says at least 3,000 wealthy taxpayers—a third of them doctors—invested with American promoters, who bought their franchises for up to $25,000.

The company was founded in the Cayman Islands, a tiny British colony of 17,000 with strict business secrecy laws that have transformed it into the Caribbean's leading tax haven. Half of all IRS criminal investigations now involve such offshore money centers.

The founders aggressively marketed their smorgasbord of tax plans. They took out full-page ads in The Wall Street Journal and paid prominent speakers, including former senator Eugene McCarthy (D-Minn.), to draw people to their tax seminars in the Cayman Islands. McCarthy says he was just a speaker and knew nothing of the company's operations.

IRS officials contend that the company's offerings went far beyond the legal shelters strewn throughout the tax code. They charge in court papers that USTPS advocated the use of bogus transactions to produce fraudulent deductions, largely by moving investors' money through Cayman banks and returning it to them in disguised form.

Each plan involved setting up a Cayman Islands corporation to invest money provided by the American client. The offshore firm is placed under foreign directors, but the client, who is listed as a "consultant," gives the marching orders, according to the IRS. Even if the company does nothing more than invest in bank certificates, the client can hide the account from the IRS and avoid paying taxes on the money.

"You have to be a little deceitful to get involved in this shelter," a USTPS promoter in St. Paul told an undercover IRS agent.

Lynford R. Evans, an accountant who was president of USTPS and now runs a new investment company out of the same Cayman Islands office, said the IRS allegations are untrue and greatly exaggerate the size of USTPS. He described himself as "an innocent bystander" who had only a loose affiliation with the American promoters.

The IRS has no jurisdiction over Cayman citizens such as Evans and is barred by Cayman law from conducting investigations on the islands.

Evans said USTPS was a small firm that never made a profit and was put out of business by the IRS last year. He called the estimate that it had 3,000 clients "so off the wall it's just incredible."

"We dealt with tax avoidance, not tax evasion," Evans said. "We never recommended tax evasion."

How Offshore Shelters Are Promoted

IRS affidavits and tape transcripts paint another picture of how offshore shelters are promoted behind closed doors. According to the documents, prime selections on the USTPS menu include:

- **The Mastercard Account**—This is one of several ways an American client can gain access to his money after it is placed in a Cayman bank. The client is issued a special credit card to tap the funds, but the account is not listed in his name or reported to the IRS. The money can also be brought back to the United States through loans, gifts and scholarship funds.
- **The Medical Malpractice Plan**—An American doctor writes a large check to a small Caribbean insurance company selected by USTPS. The doctor deducts the insurance "premium" as a business expense, although the IRS says no real insurance was involved.

The Caribbean company keeps 10 percent as its fee and forwards the rest to a "friendly" reinsurance company, which is secretly directed by the doctor. He can reclaim 90 percent of his money at any time through loans and other means.

A USTPS promoter in Dallas with 200 doctors as clients told an IRS agent that he refers to this plan as "naked insurance" because nothing exists.

- **The Consulting Study**—The client buys a bogus study of European video games or some other topic, deducts the fee as a research expense and secretly gets most of his money back. A promoter in Humble, Tex., told an IRS agent that USTPS had companies in six countries to do the studies, including "a Swiss corporation with a German name, a Bahamian corporation with a French name, a Liberian corporation with a South African name, a Panamanian corporation with a Spanish name."
- **The Congregational Church of Human Morality**—The client buys a "parish" at this church, whose address is a post office box in South Carolina. The tax-deductible "donation," minus a 10 percent handling fee, is deposited in a Cayman Islands account and can be reclaimed at a later date.
- **The Payroll Plan**—The client enrolls in a plan that purports to transform his wages into tax-free "gifts." His salary, minus the standard 10 percent, is moved to an offshore trust and then secretly returned to him. The Justice Department recently obtained a court order barring George D. Sprague, a USTPS associate in Charleston, S.C., from operating this and other tax shelters.

Evans said that if some of his American associates promoted illegal shelters, they did so without his knowledge or after they had broken off relations with him. He said the medical malpractice plans promoted by USTPS involved bona fide insurance, and that many of the offshore shelters he recommended were backed by legal opinions.

Richard Wassenaar, assistant IRS commissioner for criminal investigations, called such arguments "a bunch of hogwash."

"Not every offshore corporation is illegal, but the vast majority are," Wassenaar said. "If you or I set up a bank account in the Caymans, chances are we would do it only for the purpose of evading taxes. Why would we want an account 3,000 miles away when we could have one around the corner?"

USTPS was born several years ago when California economist James G. Bryan moved to the Cayman Islands and teamed up with Evans. They began holding daily tax seminars at the Grand Cayman Holiday Inn, where visiting Americans got to see a videotape of Bryan touting various tax avoidance schemes.

Early last year, an IRS agent on vacation noticed magazine and billboard advertisements for the seminars and stopped in at one of the sessions. It wasn't long before an investigation was under way.

Attorney Was Early Government Target

One of the government's first targets was Robert Schwind, whose name had turned up on a list of USTPS associates.

Schwind knew the banking business: he had supervised 350 banks in Georgia, Florida and South Carolina as regional counsel for the Comptroller of the Currency in the 1970s. He is also an old friend of Bert Lance, President Jimmy Carter's first budget director.

In 1980, Schwind became enmeshed in the controversy involving Carter's brother Billy and his ties to Libya. The Atlanta attorney tried to strike an agricultural export deal with Libya that could have brought Billy Carter huge commissions.

After attending a USTPS seminar, Schwind started working on offshore tax shelters from his Peachtree Street office, where he was later joined by David Hill, an Atlanta tax expert.

On March 15, 1984, IRS undercover agent James P. Lewis met with Schwind and Hill in Atlanta on behalf of a fictional client. Schwind and Hill told him about the malpractice insurance plan and other offshore ventures, according to tape recordings later cited by Lewis in an affidavit.

Hill said he and Schwind had a close relationship with a Cayman Islands bank that "can't be blackmailed at all." Schwind said one of their clients was an Alabama doctor who earns $800,000 a year.

"A big key is the secrecy of it . . . . It ain't for big talkers," Hill said.

Schwind assured Lewis that his client's money would be safe. "With some of our clients, I think that if we stole from them, you might just end up in the trunk of a car at the airport," he said.

Lewis gave them $5,000 to open an offshore account, but the investigation was aborted, the IRS says, when Schwind and Hill apparently became suspicious and returned the check.

Meanwhile, another IRS sting was unfolding in Missouri. The agency had recruited a businessman, known as Mr. A, to pose as a wealthy developer. Agent One, a flamboyant IRS veteran from the St. Louis office, pretended to be his son-in-law.

At a resort hotel in Osage Beach, Mo., they made contact with two Missouri real estate men, Galen Heritage and Pat McNally, who said they were working with USTPS. The March 1984 conversations were recorded and later described in an IRS affidavit.

"We can eliminate your tax liability pretty much completely from this day forward," McNally told the prospective clients.

Heritage described a medical malpractice plan, saying that "you can dump about all the money you want in that thing. It's just simply an overfunding of some insurance."

McNally said the client can tap his offshore funds through a Gold Mastercard with a $100,000 credit limit. He said the client would serve as a "consultant" to the offshore company holding his money.

'Consultant' Would Decide on Loans

That money, McNally said, "can be loaned out based on recommendations of the client, or the consultant . . . . If the consultant recommends that foreign corporation loan that money to Howdy Doody, that foreign corporation's, by God, gonna make a loan available to Howdy Doody."

They soon got down to business. Agent One said he had $150,000 in cash from a real estate deal; McNally said he knew someone who could handle it. "As a matter of fact," he said, "the attorney will fly here to get it. Anytime I want."

He called Schwind in Atlanta.

On April 8, 1984, Schwind and Hill met in Missouri with McNally and his two clients. Schwind said they liked to ensure a "double layer of secrecy" by forming a company with offices and directors in the Cayman Islands, but registered in the Turks and Caicos Islands, another Caribbean tax haven.

Their fee was the same whether they were moving $100,000 or a much larger sum, Schwind said, because "we are putting our necks on the chopping block each time."

He would not say how they moved money out of the country, but noted it was "nothing as romantic" as flying it out on a small plane.

Schwind said he typed all correspondence himself because "you never know when [a] secretary might leave, might attempt to intimidate you or extort money out of you."

At a meeting with McNally the next day, Schwind and Hill said they would charge a 12 percent fee to launder $100,000 offshore, and another 4 percent to bring the money back into the United States as a loan.

Two days later, Schwind and Hill met with their newest customers at Atlanta's Ritz-Carlton Hotel. The IRS men handed over the $116,000.

They agreed that the funds would be wired to Agent One's bank account in Houston after an offshore firm called MEAK Realty Co. was set up. "We're the attorneys for the corporation," Hill said. "But if someone subpoenas us, we say, 'Hey, we don't know who the shareholders are.' "

In the following days, Schwind put the agent's money in an Atlanta bank account in the name of Escrow Services Inc. He incorporated MEAK Realty Co. in the Turks and Caicos Islands. And to create the appearance of a foreign transaction, he generated fictitious loan papers showing a $100,000 debt to a Cayman Islands bank. This would make the laundered money look like a legitimate loan to Agent One.

The $100,000 was then wired from Atlanta to the agent's account in Houston. On April 20, the transaction was complete.

Three weeks later, armed IRS agents with search warrants raided the offices of Schwind and Hill and other USTPS promoters across the country. The probe was now out in the open.

James R. Wyrsch, an attorney representing Heritage and McNally, said that "the two of them deny that they thought they were doing anything illegal." He said the IRS' taped excerpts "failed to disclose things that Heritage and McNally said that we said were favorable to them and showed a lack of criminal intent."

David W. Russell, Wyrsch's partner, said that McNally "was a sales agent involved in the selling of some programs. He relied on the expertise of others and says he hasn't done anything wrong."

Federal Investigation Continues

Schwind and Hill pleaded guilty last May. Prosecutors said the pair had also laundered $766,000 through a Cayman Islands company for a Georgia cocaine trafficker, John Robert Jones.

On Sept. 3, Schwind was sentenced to one year in jail, Hill to four months. Both were disbarred as lawyers.

The investigation is far from over. In Atlanta, assistant U.S. attorney James E. Fagan Jr. has given a federal judge the names of 25 affluent businessmen who worked with Schwind and Hill; the clients are suing to keep their names secret.

In Washington, IRS officials are pressing legal action against several USTPS promoters.

And in the Cayman Islands, Lynford Evans sits at his desk in the half-empty building near the airport that once housed 30 USTPS employees. He and his attorney complain that the IRS has been using "Gestapo tactics."

Evans said he knew nothing of the money-laundering by Schwind and Hill. Like many of his American associates, he said, "They just wanted to know what we were doing and to do it themselves. They simply plagiarized us. Most of these guys met with us and then started their own deal."

Evans said the IRS is "wasting their time and the taxpayers' money" by continuing the investigation. Pointing to a box full of metal stamps, each emblazoned with a different corporate seal, he said: "That's all that's left of USTPS."

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3 of 4

IRS Tracks Offshore Money-Laundering Schemes

Caymans Lure Business With Tax-Free Secrecy

GRAND CAYMAN, Cayman Islands—Millions of dollars change hands each day in this slow-paced speck of a country, whose 450 banks have turned it into the fastest-growing tax haven in the Caribbean.

There are 18,000 foreign corporations registered here, more than one for every resident of the Cayman Islands. Many are lured not by the warm sun and quiet beaches, but by the tax-free environment and business secrecy laws that make it easy for wealthy Americans to avoid income taxes.

The kind of companies Americans invest in is illustrated by the directory of a modest two-story building here. There are 201 corporate names in all—from Ascot Trading Co. to Zeus Ltd.—but they have no offices inside. Most of the building belongs to the Bank of America.

Such companies provide a financial lifeline for this British colony 460 miles southwest of Miami, which lives off tourism and tax avoidance. Its only other industry plummeted after the United States banned turtle imports in 1978, yet it has more banks per capita than anywhere in the world.

"Cayman has become the Switzerland of the Caribbean," said Orren Merren, a Cayman attorney who has represented the islands in Washington. "It's a British colony without a lot of social tension. It's a good location and the banks themselves may get some tax benefits."

Cayman officials dislike their reputation as a money-laundering center for drug dealers and agreed to cooperate with U.S. narcotics investigations last year. However, anyone caught disclosing financial transactions here without official sanction faces a two-year prison term.

Merren noted that tax evasion is not a crime here and that "one country is not obligated to help another country supervise the collection of its revenues. The fact that people are evading taxes . . . that's between them and their government, or them and their conscience."

A British Embassy spokesman said that Britain is concerned about abuses of Cayman banks and has been discussing the problem with Cayman and U.S. officials.

U.S. authorities say the flow of illicit cash here—up to $10 billion a year, by some estimates—would not be possible without the cooperation of major banks. Most of the Canadian, British and Swiss banks in Grand Cayman will accept large deposits from Americans with few questions asked.

At the Bank of America's subsidiary here, an officer told a visiting American that he could not open an account for less than $250,000. "If it's $50,000 or $100,000, we figure people are just bringing the money here and trying to evade taxes," she explained. But she added, "If you go through a lawyer and form a Cayman corporation, then it's all right."

That can be done in a day at the Registrar of Corporations, where the walls are adorned with 20 pages listing newly formed companies, including such ventures as Garmi, Garmo and Garmu. All you need, Carol Walker explains from behind the counter, is a list of shareholders and a registered office here. But that can be nothing more than a post office box and a local lawyer to answer your mail.

"I could have this space and cover a thousand companies," Walker said.

Some American tourists are intrigued by local magazine ads touting "All You Need to Know About Tax Havens." They come to the videotaped seminars held three times a day at the Holiday Inn for a tax-deductible fee of $25.

Although the film was produced by the United States Tax Planning Service (USTPS), which is under investigation by the Internal Revenue Service, it is still a popular draw.

The curtains are drawn in a small room, and USTPS founder James G. Bryan appears on the television screen. "Welcome to the fourth largest financial center in the world," he says. ". . . I'm Jim Bryan, and I'm the author of the U.S. Tax Planning Concept."

Music rises and an eagle's-head logo flashes on the screen as a narrator intones: "The U.S. Tax Planning Concept—dedicated to the preservation of wealth and private property."

"The U.S. was born because of a tax rebellion," says Bryan, an avuncular, white-haired man whose current whereabouts are unknown. "When the government gets aggressive and oppressive with their taxes as they are doing today, many people look for a refuge."

When Germans put their money in Swiss banks in the 1930s, he says, "The Gestapo put on a great move to try to crack the bank secrecy laws in Switzerland. Today, there are new forms of Gestapo, and those new forms of Gestapo in most countries are called tax collectors."

Bryan describes how someone earning $200,000 could cut his $68,500 tax bill to zero by setting up an offshore corporation and investing in such things as diet plans and oil wells. He draws boxes and arrows to show how a taxpayer can put his money in a Cayman company, under foreign directors and trustees, and still direct its flow.

After the showing, viewers are offered a free consultation at International Services Group Ltd., which operates out of the same office once used by USTPS. The company, which puts out a booklet called "Tax Haven Journal," also has the same phone number, post office box and eagle's-head logo as USTPS.

Lynford R. Evans, director of International Services Group, said his new company, unlike USTPS, does little tax work. He said he uses the seminars to attract potential clients.

Evans, a thin, bearded man who laughs easily, said he was still using the Bryan videotape because he couldn't afford a new one. "The only thing we have that's making any money is the Holiday Inn seminar, so why check it?" he said.

Evans said the IRS has singled out his former company for practices that are common in his native country.

"That's how the Cayman Islands survives," he said. "We're a tax haven . . . . Do you want to do business with someone down here, or do you want to give 50 percent of your income to the IRS?"

—Howard Kurtz

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(p. 10)

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Bankers Face Trial Today for Aiding Smugglers in Getting Control of Bank

By MARTHA BRANNIGAN
Staff Reporter of THE WALL STREET JOURNAL

MIAMI—A federal trial is set to begin today in what is believed to be the first case that charges bankers with helping drug smugglers acquire control of a financial institution.

Ray L. Corona, suspended chairman of Sunshine State Bank, and his father, Rafael L. Corona, the suspended managing director, are accused of helping Jose Antonio Fernandez, a convicted drug smuggler, and a partner to buy control of the Miami bank, using a nominee to hide ownership.

The trial, which is expected to last three months, marks the culmination of a bitter battle between the Coronas, who are Cuban immigrants, and federal authorities, who have long been trying to wrest control of the small bank from the Coronas.

Mr. Fernandez plans to testify as the star witness for the U.S. Attorney's office. Last week, he was sentenced to 50 years in federal prison after pleading guilty in March to all 17 counts charged in the indictment.

Colombian Marijuana

He admitted to importing some 635,000 pounds of Colombian marijuana into Florida, Texas and Louisiana; setting up phony businesses to launder drug money; and buying a lavish beachfront estate, horse farm, and other real estate to hide the profits of his marijuana business.

The key charge in the indictment, however, is that the Coronas helped Mr. Fernandez and his partner—Gerardo Jorge Guevara, Mr. Fernandez's brother-in-law, who is also accused in the case—acquire a 51% stake in Sunshine State.

Mr. Fernandez and his partner allegedly used Alma Robles Chiari, a granddaughter of a former Panamanian president, as a front. Ms. Robles Chiari was granted immunity for her cooperation in the case.

Specifically, the Coronas are charged with conspiring with Mr. Fernandez and Mr. Guevara to arrange for them to buy the bank's stock through a nominee, Ms. Robles Chiari, and also with hiding the ownership of the bank from state and federal banking authorities by falsifying books and records at the bank.

Federal authorities also allege that after Mr. Fernandez became a federal fugitive, the Coronas helped him dispose of his hidden stake in the bank by purchasing it from him.

The Coronas allegedly received management jobs in the bank in exchange for their illicit aid.

The government hasn't alleged that the bank was used to launder drug profits. However, it claims that at one point Ray Corona provided $250,000 from the bank for a marijuana transaction.

Coronas' Defense

Ray Corona, 37 years old, is a flamboyant boxer-turned-banker known among Miami banking circles for his ostentatious style and conspicuous consumption.

The Coronas' attorneys say they will assert in their defense that the Coronas never knew that Ms. Robles Chiari was acting as a front for Mr. Fernandez.

I. Barry Blaxberg, general counsel to the bank, asserts the Coronas are the subject of a government vendetta. "The government is letting the big fish off and going after the guys they say did the fronting. We think it's to get the Coronas out of banking."

Last year, before the indictment, the Coronas succeeded in getting a federal judge to overturn an order from the Federal Deposit Insurance Corp. that had suspended them from their bank jobs on grounds of mismanagement.

Separate from the criminal case, the FDIC's board is currently considering an administrative-law judge's confidential recommendation on whether the Coronas should be allowed to hold those posts.

Also charged in the case are Mr. Guevara, accused of drug smuggling, racketeering, and conspiracy in buying an interest in the bank; Manuel Lopez-Castro, a Miami attorney charged with laundering money through various Panamanian corporations; and William Vaughn, a business associate of Mr. Fernandez, charged with money laundering.

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Money
Laundering

Anticrime Attack Pays Dividends

U.S. Seeks to Put a Stop Payment on Money Laundering Schemes

By Mary Thornton
Washington Post Staff Writer

The federal assault on money laundering is hitting pay dirt.

Nearly three years after warning that a crackdown was coming, the government is striking hard against the use of banks to shield the profits of organized crime and drug trafficking:

- Early this year the Bank of Boston was fined $500,000 after pleading guilty to failing to report $1.22 billion in cash transactions with foreign banks—some for companies owned by a local Mafia family.
- In a case that will go to trial soon, New York heroin traffickers are accused of using accounts at E.F. Hutton & Co. to launder $15.6 million, much of it cash stuffed into gym bags. The brokerage house has not been charged with wrongdoing.
- On the West Coast, a group of elderly women recently laundered $25 million in a "smurfing" operation—going from bank to bank depositing just under $10,000, the amount at which a currency transaction form must be filed with the Treasury Department.
- More than 100 other money laundering investigations are under way across the nation, according to a high-ranking Treasury Department official.
- Treasury Secretary James A. Baker III disclosed this week that his department may create an office of financial investigation to attack money laundering and other crime in the banking industry.

U.S. officials say their increased priority on money laundering investigations pays double dividends: The seizure of illegal assets can cripple a criminal organization and mob kingpins who are well insulated from their illegal activities can often be linked to the profits.

A typical money laundering scheme allows an individual to transform cash into funds that cannot be traced. It can provide a legitimate cover for large profits from, for example, drug trafficking, prostitution, gambling and other illegal enterprise, that he otherwise cannot account for.

The money launderer might secretly transport the funds, by courier or bank wire, to a corporate account in a foreign country where taxes are low and banking records are secret. His corporation, which probably would exist only on paper, could then lend the money back to him, and he might even take a U.S. tax writeoff on imaginary interest payments.

In 1982, U.S. Customs Commissioner William von Raab warned the banking industry of the coming crackdown on money laundering in what is now known as his "fire and brimstone" speech to the Florida Bankers Association.

Von Raab says he believed then that some Florida bankers were "complicit, not just fellow travelers," with drug dealers seeking to launder their profits and that the bankers' compliance with federal law requiring them to report large cash deposits was "lousy."

As the television cameras rolled, von Raab told the bankers he was "ashamed" of them. "Then, when I told them that there were a lot of sleazy bankers in Florida, all hell broke loose. Guys leapt up and started screaming and yelling." The convention, scheduled through the next day, was quickly adjourned.

The speech was an abrupt signal that the federal government was about to get serious about the 1970 Bank Secrecy Act, which was amended in 1980 to require financial institutions to notify the Treasury Department of cash transactions of $10,000 or more. Starting this month, gambling casinos also must notify Treasury of such transactions.

Many federal law enforcement officials view the Bank Secrecy Act as one of the government's top weapons against organized crime and drug trafficking.

"Investigating money laundering is an indirect way to get at the mob," said James Harmon, executive director of the President's Commission on Organized Crime. "We recognized pretty early that you've got to figure out a way to get at the economic benefits of organized crime. Narcotics, labor payoffs, payoffs to public officials—the problem for them is always how to get rid of the cash. The common denominator is always cash."

John M. Walker Jr., assistant treasury secretary for enforcement, told a congressional committee recently, "If we can trace the money, the trail will often lead to high-level criminals. The leaders in any criminal enterprise usually take great pains to distance themselves from the illegal source of their income. But they can usually be found close to the money."

No one knows for certain how many U.S. dollars are laundered each year, but law enforcement officials agree that most of the flow comes from drug trafficking and that the volume is astounding.

One Treasury Department official said money laundering by American banks is "a situation that occurs hundreds of times, if not thousands of times, each day. Many major cities have gambling, horses, prostitution. It's a daily business. There has to be some means of laundering that flow of money."

Walker said estimates indicate $50 billion and $65 billion a year is laundered from drug trafficking alone.

"We know that a single money laundering enterprise can wash $300 million or more in crime proceeds in less than a year's time," he said.

Rep. Charles B. Rangel (D-N.Y.), chairman of the House Select Committee on Narcotics Abuse and Con-

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WILLIAM VON RAAB
. . . gave bankers "fire and brimstone"

trol, recently estimated that drug profits reach as much as $110 billion annually.

Richard Mangan, a money laundering expert in the Drug Enforcement Administration, warns, "They all are ballpark figures. Drug organizations are not posting year-end profit statements."

With its new emphasis on the Bank Secrecy Act, Walker says that the Treasury Department has seized $81.6 million in currency and $34.3 million in property since 1980 but he believes those numbers will grow dramatically in the future.

The most prominent investigation is the ongoing federal grand jury probe of the Bank of Boston, whose chairman, William L. Brown, has said, "Through confusion and error, we failed to incorporate [the 1980 change in the reporting law] into our operating procedures."

Brown has also said that two companies controlled by members of the Gennaro Angiulo organized crime family were placed on a special "exempt" list of special bank customers—usually reserved for large cash-producing retail operations—that are not required to file the Treasury Department forms.

In a case known as the "pizza connection"—because of the New York pizza parlors accused of serving as fronts for a $1.65 billion heroin trafficking operation in the early 1980s—launderers allegedly made deposits of $4.9 million at Merrill, Lynch, Pierce, Fenner & Smith Inc. before officials there became suspicious and closed its accounts and $15.6 million into accounts at E.F. Hutton & Co.

U.S. Attorney Rudolph W. Giuliani, whose New York office is handling the "pizza connection" case, said, "People were walking into E.F. Hutton with a million or one and a half million dollars in cash that was eventually going into Swiss accounts."

Giuliani said that when federal investigators subpoenaed records from E.F. Hutton and asked Hutton employees specifically not to mention it to their client, Hutton "tipped the suspect . . . . It made it impossible to go forward with the investigation at that time. When the customer was notified, he ceased all transactions."

A year later, by chance, investigators developed additional information involving the same suspects and were able to proceed with the case, Giuliani said.

A spokesman for E.F. Hutton said the investment firm refused further cash deposits from the suspect after it was informed that the money might be coming from organized crime. He said the customer was informed of the decision before the federal investigators made their request for secrecy. "It's a very unfortunate misunderstanding . . . . We had no intention of aiding crime," the spokesman said.

As for accepting the large cash deposits, the E.F. Hutton spokesman said all required reporting forms were filed with the Treasury Department.

Federal investigators say large-scale money laundering operations use both U.S. and foreign banks, particularly those in such traditional tax havens as Switzerland, Panama, the Cayman Islands and the Bahamas.

Law enforcement officials say their successes have forced criminals to turn to cruder methods of laundering cash.

Some simply fly it out of the country. But von Raab points out that a suitcase with $1 million in $20 bills weighs more than 100 pounds.

Other launderers deal in smaller sums to avoid the reporting requirements. In the "Grandma Mafia" case, a group that included several grandmothers was accused of running a $25 million cocaine operation from Florida to Los Angeles and then laundering the money through California banks. Several people have been convicted in the continuing case.

But there have been problems.

Federal law enforcement officials complain that authority for examining banks, credit unions and savings and loans is scattered among five agencies, depending on the type of financial institution. In addition, they say, there are no uniform qualifications required for the

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JAMES HARMON
. . . "indirect way to get at the mob"

examiners, and many are not trained accountants or auditors.

Mangan adds that money laundering schemes are growing more elaborate.

"We used to go in with search warrants and seize notebooks and ledgers. Now, we go in and get computers and floppy disks," he said, adding that trafficking and laundering methods vary in different parts of the country.

"In Florida, you're talking about cocaine and Panamanian bank accounts . . . . In New York, it's the Chinese heroin traffic out of Thailand and Hong Kong. There's much less use of the traditional banking system and a great deal of use of underground banking systems—gold shops, family connections . . . . The paper trail is far less obvious, the track is much more difficult to follow," he said.

Despite problems, federal enforcers believe there has been progress. Von Raab estimates that since 1980 bank compliance in reporting cash transactions has jumped from about 10 percent to 80 or 90 percent today, and several bills are pending in Congress to ease the federal access to records of financial transactions.

And in the end, officials say, the strongest push may come from the public. After all, they reason, who wants to do business with a bank that has been exposed as having been used for money laundering by some criminal enterprise?

For example, a recent bankruptcy filing by a Deak-Perera subsidiary was precipitated in part by customers withdrawing deposits after the President's Commission on Organized Crime reported that a 1982 Internal Revenue Service investigation had discovered that a convicted Colombian drug trafficker had laundered about $97 million through Deak-Perera.

Giuliani says he hopes that banks have learned a lesson from the federal spotlight on money laundering. "An institution with any self-respect wouldn't want to be used for furthering criminal activities," he said.

"Banks and financial institutions should follow the know-your-customer rule. They should know what business the customer is in. If not, they should check it out. If you write down that you're a baker, and then come in with $1 million every two or three weeks, then either you're the biggest baker in the United States or you lied."

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Spotlight ☐

Money Laundering

Drug barons hide billions

Easy access to banks, firms

First in a series

When Bob Hope appeared in Worcester during his last Massachusetts tour, Mayor Jordan Levy gave the comedian the keys to the city. But the main investor in the firm that recruited Hope and paid his performance fee avoided the limelight. Arnold Katz didn't even attend the show.

At the time, Katz was one of the leading cocaine dealers in the United States. Although he lost money on the Hope show and on other events he produced, he gained something else from his career in promotions – a cover story and a way to launder some of the bundles of cash he was reaping from cocaine.

Criminals like Katz operate almost entirely in cash. Laundering the cash to conceal its illegal origins is as much a part of their business as off-loading drugs from mother ships or using personal threats to collect on bad loans.

Altogether, America's criminals launder $40 billion annually, according to government estimates. Their success is a testimony to their easy access to financial institutions both in the United States and overseas, and to the government's failure to block the flow of illicit cash through legitimate banks and businesses. Although their laundering trails are often long and winding, criminals have encountered few obstacles along the way.

Investigators have only recently begun tracking criminals by following their financial footprints. They have belatedly recognized that top criminals devote as much effort to hiding illegal income as they do to planning and consummating illegal deals.

"First we went after the product, but now we're concentrating on the money," said Martin J. White of Interpol, the international police organization. "Everyone realizes now that the head of the operation doesn't stand near the drugs, he stands next to the money."

Adds Janis M. Berry, a Boston-based assistant US attorney: "There'll be no winning the war against drugs until as much time is spent looking at what a dealer did with his money as is spent looking at how he made it."

But the task of tracing illicit cash has proven difficult, and has often clashed with Americans' desire for financial privacy.

While criminals ordinarily deal in large amounts of cash, so do businesses, like supermarkets and parking garages. To distinguish criminal profits from legitimate gain, investigators need information about all major cash transactions. Yet legitimate businessmen have objected to such scrutiny as an invasion of private dealings. And banks that handle large amounts of cash have been unwilling to grill customers about the sources of their money.

Lacking the information from banks and businesses, investigators have not attacked laundering vigorously. They took more than a decade to start enforcing the 1970 Bank Secrecy Act, which requires banks and many other businesses to report cash transactions over $10,000 to the Internal Revenue Service. They have sent only four American bankers to prison for aiding launderers by not filing the reports. Even when they have uncovered a laundering scheme, they often have failed to seize the culprit's cash and property.

In an earlier era, criminals could use simple methods to hide illegal cash. But as the government has become more sophisticated, so have criminals, matching their pursuers move for financial move.

Back in the 1940s, bookmakers like the late Maurice Lynch of Revere had no problem laundering illegal cash. Lynch, who was named in mobster Vincent Teresa's 1974 autobiography as the second-in-command of organized crime in Revere, set up a paycheck cashing service at local bars where he offered workers cash he had earned from book-

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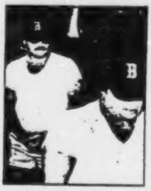
Drugs and money

How the leaders of New England's largest drug ring laundered millions they made from cocaine and marijuana smuggling.

Michael Caruana: Organized crime figure
Caruana, a marijuana distributor with high-level mob connections, laundered more than $800,000 through a precious metals company in Plymouth. Caruana used a Bahamian corporation to funnel the money to the Plymouth company. Caruana, a Nahant resident, is a fugitive under indictment for drug charges.

Arnold Katz: cocaine distributor
Katz used a laundering method known as "smurfing" to turn large amounts of cash into cashier's checks without alerting the federal government. Katz would purchase cashiers' checks for just under the $10,000 reporting limit. Katz, a Worcester native, pleaded guilty to federal charges and is in the federal witness protection program.



Robert Frappier and Timothy Minnig: marijuana smugglers
Frappier and Minnig deposited hundreds of thousands of dollars in the Bank of Nova Scotia in the Bahamas. They used some of their cash to purchase a Bahamian island as well as a California disco. Both men have testified for the government and are also under federal protection.

Frank J. LePere: marijuana smuggler
LePere carried at least $3.5 million in cash to Panama and deposited the money in the bank account of a Panamanian corporation he had formed. A fugitive for three years, Lepere was arrested at a hideaway in the Adirondacks last November and pleaded guilty to drug smuggling charges in June. A former Marshfield resident, he is currently serving a five-year sentence.

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Drug lords hide billions in banks, businesses

SPOTLIGHT

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making. In return, they signed over their paychecks to him.

Both sides benefited from the arrangement. Lynch got rid of cash that he would have otherwise had a hard time explaining to the IRS and replaced it with legitimate checks that he could deposit at a bank without arousing suspicion. And it saved the workers a trip to the bank.

Lynch used a similar technique at Wonderland and Suffolk race tracks. Bettors who did not want to cash winning tickets in at the track because large payoffs were reported to the IRS sold them to Lynch instead. By selling to Lynch, the bettors avoided paying taxes on their winnings, and Lynch ended up with tickets that he could use to cover up his bookmaking profits. If the IRS questioned him about his wealth, Lynch could always point to the tickets as evidence that he had gotten lucky at the race track.

Thirty years later, when reputed Mafia boss Gennaro Angiulo needed to hide cash from various enterprises, he had to devise a more elaborate method.

Angiulo managed to place two of his real estate companies on a list of exempt companies at the First National Bank of Boston, guaranteeing that the cash he and his associates brought in shopping bags to the bank's North End branch was never reported to the government. This arrangement worked until 1983, when the government discovered it while investigating the bank for failing to report cash transactions.

Still more recently, marijuana importer Thomas N. Rhoad 3d used a circuitous route through foreign banks and dummy corporations to buy property on Nantucket Island, where he spent his boyhood summers. Rhoad carried $1.6 million in cash on commercial flights to the Bahamas and England's Channel Islands, then had anonymous corporations wire money back to him for the real estate purchases. Rhoad is now in federal prison on a drug conviction.

Businessmen help

Criminals like Angiulo and Rhoad cannot wash their illegal cash by themselves. They need the quiet help of business people who, in the absence of any federal law prohibiting money laundering, can legally accept unlimited amounts of cash.

There is the contractor who has fallen on slow times and prefers cash payments that he need not report on his income tax. There is the banker who fears that if he rejects anybody's cash it will be deposited with a competitor. And there is the lawyer who is sworn to protect his client's confidentiality and forms corporations without asking the name of the true owner.

In Katz's case, for example, some lawyers who represented the cocaine distributor and his street dealers were offered cash for their services. One lawyer, who spoke only on the condition that he not be identified, said he did not inquire about the source of the cash.

"A client would come in with $2,500 in cash and tell me, 'Thank God for Arnie or I couldn't afford you,' " the Boston lawyer recalled, adding, "I have heard stories of people who paid their attorney $1 million in cash."

Increasingly in recent years, many criminals have laundered money in foreign countries where attorneys ask even fewer questions than their American counterparts and stringent secrecy laws protect bank accounts from US investigators.

Drug dealers routinely break US law by carrying more than $10,000 in cash on international flights without reporting it, because they know that the US Customs Service rarely searches outbound passengers. Cars, boats and private planes carry cash out of the United States. Maine, for example, has 60 unguarded border crossings with Canada and more than 200 remote airstrips; a plane seized in July 1983 at Sanford Airport was equipped with 10 extra fuel tanks for nonstop flights to Colombia.

Once the money is deposited in an overseas bank, the criminal has the choice of writing checks on the foreign account or wiring funds to a US account. Either way, the cash has now been converted to check, and its history has been erased.

As repositories of drug money, Caribbean countries such as the Panama, Bahamas and the Cayman Islands have largely replaced the traditional secrecy haven of Switzerland, which has cooperated with US investigators since a treaty between the two countries took effect in 1977.

Economies at risk

US investigators need banking records in these Caribbean countries to follow the cash trail. Yet Panamanian officials say their country would risk economic suicide by divulging financial information, because frightened depositors – including foreigners who maintain dollar accounts abroad to avoid taxes, as well as drug traffickers – might remove their money. Panamanian banks have never cooperated with US investigators, and treaty negotiations on the issue of access to banking records have dragged on for four years.

"There is no such thing as good or bad money," said Jorge Riba, minister of government and justice in Panama. "To me, money is neutral."

"Once the money goes offshore," lamented one US Senate investigator, "it's gone."

Stashing money abroad was a favorite device during the past decade among a group of major drug traffickers that included Katz, Robert L. Frappier, Timothy I. Minnig, Salvatore Michael Caruana, Frank J. LePere and Kevin R. Dailey. They formed one of the biggest drug rings federal officials have ever busted, one that smuggled in most of New England's marijuana and cocaine. Wherever they hid the cash they earned from drug sales, they had the same purposes in mind: protection against US investigators, and freedom from American cash reporting laws.

- Frappier and Minnig imported 167,000 pounds of marijuana to New England between 1974 and 1983. Both have pleaded guilty and given evidence against other traffickers. They are currently negotiating forfeiture of $6.7 million in assets to the government.

The pair testified in 1984 that they deposited hundreds of thousands of dollars in cash in the Bank of Nova Scotia in the Bahamas. Minnig also bought a Bahamian island through cash payments to a local businessman who acted as a front for him.

"All transactions were made in cash in this business," Minnig has testified.

- Caruana, a high-level organized crime figure who assisted Minning and Frappier in their marijuana smuggling, moved at least $1 million to the Bahamas. He deposited the money in the bank accounts of front corporations there and later wired $800,000 to a Plymouth precious metals company he controlled. Indicted on drug charges, Caruana, a former Nahant resident, is now a fugitive.

- LePere, a Marshfield businessman, earned an estimated $25 million by buying Colombian marijuana and unloading it from mother ships anchored off the coast. He and his South Boston-based partner, Dailey, pleaded guilty to narcotics smuggling charges in June.

According to court documents, LePere carried $3.5 million in cash to Panama last year, and formed a Panamanian corporation, Video Products International. But investigators have not established how he used the corporation or where he disposed of the cash.

An attempt to trace LePere's money ran into the barriers of Panama's banking and corporate sectors. Even confirming LePere's ownership of the corporation from Panamanian public records alone was impossible. According to documents at the public registry in Panama City, Video Products International issued "bearer" stock. In other words, there was no owner of record: whoever held the stock certificates controlled the corporation. The directors listed were nominees paid by the law firm of Porras and Valdes, which organized the corporation. The address given was the law firm's. The purpose was to conduct "any lawful business."

More than any other figure in this major drug network, Arnold Katz took pains to distance himself from his cash.

A mayor's son and the one-time owner of a popular Worcester restaurant, Katz grossed an estimated $50 million by distributing cocaine and marijuana nationwide from 1979 to 1981. "He was by far the biggest we've ever seen (in New England)," said regional Drug Enforcement Administration head Robert M. Stutman. Arrested in 1981, Katz has provided information as a government witness that has helped obtain a dozen convictions. He is expected to testify at several upcoming drug trials.

While Katz has described his narcotics operation to investigators, less has come to light about his laundering methods. Retraced through interviews and documents, Katz's transactions suggest that he followed the advice of several volumes on money laundering that he kept in his bookshelves, arranging his finances so he could dispose of cash without triggering the federal reporting law. Along the way, he was helped – sometimes unwittingly – by a number of businessmen who accepted his cash without asking questions.

In the summer of 1980, for example, Katz bought a 39-foot boat called the Solitary Bird from Wells Yachts in Marblehead. He faced this problem: If he paid the

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$127,800 purchase price in cash. Wells would deposit the cash in a bank, which would report the amount to the government since it was greater than $10,000. Alternatively, if he paid Wells with a $127,800 cashier's check that he had purchased in cash, the bank that sold him the check would report the transaction to the IRS. Either way, Katz risked having federal investigators pick up his financial trail and begin asking questions about how he had obtained the cash.

Katz solved his problem by buying a series of cashier's checks, each for under $10,000. According to Wells company records, Katz paid for the yacht with eight cashier's checks of $9,000 each, one check for $9,500 and one for $7,000. Only one cashier's check – for $15,500 – was above the $10,000 reporting limit, and it alone would not have been enough to draw investigators' attention. (The company's records do not account for the other $23,800 of the purchase price.)

This technique of buying a series of checks worth less than $10,000 apiece, now commonly known as "smurfing," has become a popular laundering method on the West Coast. Drug traffickers pay a small commission to couriers who rush from one bank branch to another, buying the checks. In one California scheme, runners bought 2,000 cashier's checks at 513 different banks in one day.

Clinton Wells, owner of Wells Yachts, said in a recent interview that his wife suspected Katz was a drug trafficker even though Katz told the couple that he had inherited money from his father. While Wells was familiar with the requirements of the cash reporting law, he said, he did not press Katz to explain the use of multiple cashier's checks under $10,000.

"Basically, it was none of my business," Wells said.

Dealers avoid law

At a court hearing last year, Katz acknowledged he was well aware of the danger to drug dealers posed by the cash reporting law. He testified that he once had told a partner, John Hamlet, to sell an airplane on the West Coast for cash and then use the cash to buy 22 cashier's checks of less than $10,000 apiece. Hamlet was arrested before he could make the deal, and is now in jail.

Asked under cross-examination why the checks had to be under $10,000, Katz said, "[Cashier's] checks of $10,000 are reported immediately to the IRS."

Q. And so you did not want this money to be revealed to the US government, correct?

A. That's correct.

Q. You were familiar enough with banking regulations so that you took precautions against leaving a trail that could possibly be traced back to you, correct?

A. Yes.

Katz did not always replace cash with cashier's checks in order to evade the cash reporting law. On one occasion, The Globe Spotlight Team found, he paid $185,000 in cash for an airplane. But, in this instance, he made the purchase under an alias. Even if the plane's seller reported the transaction to the government, federal investigators would have no way of knowing that Katz was involved since his name did not appear on the deal.

In August 1980, Katz and a pilot named Charles D. Schrein flew to Atlanta to buy the airplane, a Piper Navaho. Three months later, the plane crashed in Long Island Sound, reportedly while heading to Bridgeport, Conn., to collect cash from marijuana sales. Schrein and two passengers were killed. The plane was never recovered, and Katz replaced it with a Cessna 421 that he bought from LePere for $260,000 in cash.

A federal probe followed the crash, as did a lawsuit by the estates of the two passengers against Schrein's estate and Katz, alleging negligence. But investigators and plaintiffs had an unexpected problem – establishing Katz's legal ownership.

It turned out that the plane had been purchased under the name of Lee Duncan, an alias given by Schrein. Katz's name was nowhere to be found. Neither Schrein nor Katz registered their ownership with the Federal Aviation Administration.

Gary Hunter, the Atlanta salesman who sold the plane to Schrein and Katz, said in a telephone interview that he did not ask them for identification. Hunter said that the pair told him they promoted rock concerts and were accustomed to dealing in cash. "I was more interested in selling the plane than in their business," Hunter said. ". . . I've never met anybody in the rock business, but it looked like they might have been."

In fact, Katz was a director of an entertainment promotion company, R.J. Heppenstall Productions Inc., which was organized in Worcester in the same month that he and Schrein bought the Piper Navaho in Atlanta. Richard Heppenstall, president of the new company, was an old friend of Katz's. He was convicted on narcotics charges last year along with seven other defendants. Katz was a government witness in the case.

"I went into the amusement business, sponsoring concerts and groups," Katz has testified. "And I lost somewhere between $125,000 and $150,000 over a period of months."

In addition to bringing Bob Hope to the E.M. Loew's Theatre, Katz's company helped produce a children's Christmas show and a Lewiston, Maine, rock concert in September 1980 by The Grateful Dead.

Besides the promotion firm, Katz invested in other "young growth businesses that needed investment capital," a lawyer who once represented him said in an interview.

It could not be determined whether Katz maintained sizeable bank accounts in the names of Heppenstall Productions or his other businesses. If he did, he was using one of the oldest of laundering techniques. People involved in allegedly criminal activities, like Lynch, the late Revere bookmaker, have often bought money-losing "front" companies and then pumped dirty cash through the firms' bank accounts, so that the money appeared to come from legitimate sales.

Besides his check-cashing service, for example, Lynch ran a toy and novelty shop in Revere. He bought goods for the store cheaply and sold them at a loss so that the store did not produce much cash itself. Then he made up the loss with cash from his bookmaking and deposited that money in a bank account under the store's name. To authorities, it must have looked as if the cash were part of the store's normal profits.

"He'd buy $20,000 worth of watches one day, 1,000 of them at $20 apiece," one of Lynch's advisers recalled. "They should have retailed at $40 to $60. But he'd be up and down Revere Beach for the next couple of days unloading them at $15 to $20."

"He didn't care if he lost money, as long as he could show that he had bought and sold them," the adviser said. "Then he would push his bookmaking money through [the bank account]."

A Boston bookmaker, Francis J. Vitello of Jamaica Plain, who was involved in a laundering scheme in the early 1960s, also owned a Roslindale bar that apparently did an extraordinary amount of cash business.

Vitello's Fireside Tavern had an account with First National Bank of Boston, according to records made available to the Globe. In 1972, bank officials identified the tavern as one of 74 customers, including only two other bars, that regularly used enough cash to qualify them for a list that exempted their transactions from being reported to the IRS. The real estate firms controlled by Angiulo later received the same exemption from the bank.

Vitello set up Swiss bank accounts in the early 1960s and deposited $1.2 million in them. After a lawsuit revealed that a Washington lawyer had tried to steal more than $700,000 from the accounts, Vitello was convicted of tax evasion.

Shortly after his bar was put on the exempt list, Vitello was indicted for tax evasion charges stemming from his deposit of the money in the foreign bank accounts. The bar was dropped from later lists.

Whether Katz washed drug cash through front companies in the United States, there is no doubt that he used foreign front companies and banks in his laundering schemes. He even claimed to have perfected a technique for smuggling money out of the United States. He discovered that men could wear women's panty hose stuffed with bundles of cash and then put clothes on over the hose. Although the men might look a little fatter because they were swaddled in cash, they did not attract the attention of US Customs agents.

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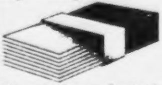
No Customs checks on cash smugglers

Spotlight



Money Laundering

Continued from preceding page

Katz frequently carried cash out of the United States, violating the law that required people who carry more than $5000 in cash across the US border to report it. (The limit has since been increased to $10,000.) But he was never caught. The one time he was nabbed under that law, he was carrying $30,000 into the United States from Aruba from a cocaine deal he had just completed. He paid a fine.

One Customs official in Miami acknowledged in an interview that there is no routine inspection of outbound passengers and baggage. Certain flights to Panama or Colombia are targeted for inspection.

Katz maintained bank accounts in the Bahamas and the Cayman Islands, a group of three islands under English control that have one bank for every 42 residents. Only his arrest interrupted his plans to open accounts in more distant lands.

"I had spoken ... to a lot of people and gotten a lot of ideas on how to move money in Liechtenstein corporations and Philippines, and Taiwan, and Hong Kong, and Singapore, and this was what I was going to do," Katz said at his 1981 sentencing hearing. "I was going to send the money out."

Katz's purchase of a Back Bay condominium in 1981 via a Caribbean corporation illustrates how offshore laundering works. Despite the financial contortions it involves, its success is guaranteed once the cash is taken out of the United States. By using a Cayman Islands corporation, Katz disposed of $185,000 in cash, avoided cash reporting by US banks, and kept his own name out of the transaction.

In 1981, Katz visited the Caymans, where he formed Schesslera Holding Co., opened a bank account in its name and deposited cash. A short time later, Schesslera wired the money to Katz's lawyer, Alan L. Jacobs, who used the money to buy a townhouse in the Back Bay with a law firm check.

Jacobs declined to discuss the transaction, but said he had not known of Katz's involvement in drugs. Katz had explained to Jacobs that he had a lot of money because he was liquidating the real estate investments of his late father.

At that time, banks in the Cayman Islands accepted unlimited amounts of cash, and promised total secrecy to depositors. As a result, many drug traffickers brought cash to the Caymans. Under US pressure, the Caymans agreed last year to release banking information to American investigators in drug-related cases. Major banks in the Cayman Islands have also stopped accepting cash deposits above $10,000.

However, a number of small Caymanian institutions still take any amount of cash. "We will accept whatever you have," one banker told a Globe reporter who inquired about bank policy.

In a similar offshore transaction, Katz purchased a 53-foot boat named "Pegasus" through a Bahamian attorney. He and a French couple carried cash on their bodies from Florida to the Bahamas and gave it to the lawyer, who then wired payment for the boat.

Given Katz's sophisticated use of foreign banks, some investigators wonder whether he still has money salted away overseas. Because they lack the time and resources to hunt for money worldwide, they must accept his say-so that the $1 million in assets he forfeited to the government constituted all of his profit from drug trafficking.

"What reason do I have to believe that, just because you've made some disclosure, you've made total disclosure?" US District Judge Marilyn Hall Patel asked Katz at his sentencing hearing.

"I mean, you've got everything to gain by making partial disclosure and thereby appearing to have complied, appearing to be cooperative, and secreting a nice small bundle away somewhere to which you can return at some point. And how could it ever be traced?"

Katz answered, "... Money is not that important to me anymore."

NEXT: *Laundering's newest hot spots*

This report was prepared by The Globe Spotlight Team, which consists of editor Stephen A. Kurkjian, reporter Daniel Golden, economics reporter Peter G. Gosselin, and researcher M.E. Malone.

Katz home seized but unsold

Four years after it was seized by the government, the expensive Back Bay townhouse remains vacant. Outside, the back yard is a jungle of weeds that choke off the dogwoods and rhododendrons. Inside, the pipes burst some time ago, ruining the first floor.

In good condition, the three-story brick building on Keswick Street would be worth $300,000. Instead, the deteriorating house has become an eyesore, a source of complaint at every meeting of the Audubon Circle Neighborhood Association. It is also a prime example of how real estate bought by a criminal through a laundering scheme can remain in limbo long after his arrest, despite the government's efforts to dispose of the property.

Cocaine distributor Arnold Katz bought the house through a Caribbean corporation in May 1981, and lived there until he was arrested a month later. He surrendered his claim on the house that August to authorities in San Francisco, where he was on trial. Since then, the government has neither fixed up the property nor sold it, although there are prospective buyers.

"It's a huge statement about the inefficiency of government," said neighbor Kathy Schultz.

Schultz said she called the US Drug Enforcement Administration in 1982 after the roof of 12 Keswick St. began leaking. She found that federal authorities in California had forgotten to forward forfeiture papers to Boston.

Former Assistant US Attorney Gregory C. Flynn, who eventually received the papers, said he was unable to dispose of the property because he could not prove that Katz had the right to forfeit it to the government. Although Katz had told the government that the house belonged to him, there is no documentation of his title.

Katz purchased the house through a corporation he set up in the Cayman Islands in the Caribbean, where financial records are secret. Without access to the records, authorities cannot show that Katz owned the corporation.

"It's very difficult to determine the relationship between Katz and that corporation," Flynn said. "Real estate is very technical, and you need to show a clear chain of title. Otherwise, you could be convicted of a crime and say, 'I forfeit the Prudential Center.'"

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West Coast cash surge linked to drug dollars

Second in a series

Spotlight

Money Laundering

SAN FRANCISCO – The white Ford Tempo was rented in August of last year by a man using a VISA card from the North Quincy branch of State Street Bank. By the time a Budget Rent-A-Car worker found the auto abandoned at San Francisco International Airport in late October, rain had turned it dingy and drowned its battery.

At first, the bags in the trunk went unnoticed. When one was finally opened out fell thousands of dollars, hundreds of gold coins and a stack of platinum bars. By the time federal agents stopped counting, the tally had topped $6 million. The cash was covered with a dusting of cocaine. The man, who had said he was a financial consultant when he rented the car, never returned to reclaim his baggage.

San Francisco authorities admit they are mystified by the case of the $6 million car. But it is only part of a much bigger money mystery: Where is all of the cash that now floods their city coming from? – $1.2 billion more than anybody expected last year and another $1.4 billion by August of this year. There's so much that the city's Federal Reserve Bank has run out of vault space and had to hire extra people to count the money.

What big cash is buying (Page 11)

Federal Reserve officials say they do not have a clue. But law enforcement officials think they do. "I think we're the country's new [money] laundering capital," said James A. Lassart, an assistant US attorney in charge of financial investigations in the Bay area.

"We're the bad guys' new frontier."

If Lassart and others are right, San Francisco is an example of how quickly criminals can shift their financial operations to outwit opponents. Its unexpected emergence as a national cash center follows a money laundering crackdown in Miami that has driven Florida criminals westward.

The city is also an example of how businesses' indifference and government delay can combine to create ideal conditions for laundering.

A Boston Globe study shows that Bay area banks fail to report one in every four cash transactions of more than $10,000, a failure rate far higher than other major cities, including Miami. The 1970 Bank Secrecy Act requires banks to file the reports, which aid the government in tracking down laundering.

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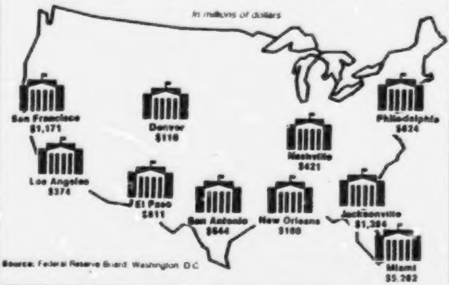
1984

Evidence of money-laundering

Huge surpluses of cash have been pouring into the Federal Reserve banks of ten American cities. Most of them rim the nation's southern and western borders



Source: Federal Reserve Board, Washington, D.C.

GLOBE MAP BY DEB PERUGI

Cash surge in West Coast banks linked to shift in US drug dollars

From Miami to California, nine border cities collect most of nation's dirty cash

Growing use of cash

Federal statistics show that lawyers, auto dealers and real estate brokers are being paid increasingly in cash. Below are listed the amounts these business groups reported being paid nationwide and in three states. US law requires bank to report all cash transactions by their business customers of more than $10,000.

Auto dealers

	1984 business volume	1984 large cash transactions reported	Increase in reported cash transactions 1980-1984
Massachusetts	$3.9 billion	$8.7 million	+ 2048%
Florida	9.4 billion	160.7 million	+ 1295%
California	16.2 billion	54.0 million	+ 1186%
United States	151.0 billion	609.0 million	+ 1527%

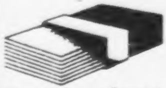
Real estate brokers

	1984 business volume	1984 large cash transactions reported	Increase in reported cash transactions 1980-1984
Massachusetts	$12.4 billion	$2.5 million	+ 262%
Florida	not available	59.8 million	+ 255%
California	not available	18.9 million	+65%
United States	450.0 billion	199.1 million	+181%

Lawyers

	1984 business volume	1984 large cash transactions reported	Increase in reported cash transactions 1980-1984
Massachusetts	$.9 billion	$2.9 million	+ 145%
Florida	1.1 billion	68.9 million	+ 121%
California	3.4 billion	10.5 million	+ 114%
United States	25.9 billion	175.4 million	+ 154%

Sources: US Treasury Department, Federal Reserve Board, state trade associations



Money Laundering

■ SPOTLIGHT

Continued from Page 1

The Globe study also shows that some Bay area businesses – especially auto dealerships and real estate agencies – are handling millions of dollars in cash each year. Their willingness to accept cash payment – even in amounts over $10,000 – primes them for the same exploitation by launderers that their counterparts in other cities have already experienced.

The study's conclusions are based on a computer analysis of 80,000 reports of large cash transactions filed by San Francisco area banks since 1980. The records were among 2.5 million cash reports and 15 years of cash surplus figures obtained by the Globe under agreements with the US Treasury Department and the Federal Reserve.

Government officials say that cash statistics can be used to pinpoint laundering, saving time and manpower. Since criminals do almost all of their business in cash, currency build-ups in certain cities or banks can tip off investigators to where launderers are operating.

However in San Francisco, authorities have barely started using the statistics. They have been so slow to take up the numbers that they admit it will be several years before they can put them to much use.

"We're beginning to realize that to hurt [criminals] we've got to get their bucks, but the realization is coming slow here," admitted Richard Jarrett, an intelligence officer with the Drug Enforcement Administration's San Francisco office. "We're going to have a tough time for a couple of years."

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10 cash hot spots

San Francisco's surplus puts it in a group of only 10 US cities that officials now consider the nation's money laundering hot spots because they draw in more cash from the economy than they pump out. The ten absorbed more than 90 percent of the extra $11.7 billion in cash that the Federal Reserve poured into the economy last year.

Nine of the 10 – San Francisco, Los Angeles, Denver, El Paso, San Antonio, New Orleans, Nashville, Jacksonville and Miami – are within a two-hour flight of the nation's southern border, which officials say can serve as a jump-off point to laundering havens in the Caribbean and Latin America. The tenth city, Philadelphia, whose Federal Reserve handles cash from the Atlantic City casinos, did not run a surplus until gambling was legalized in New Jersey in the early 1980s.

Three cities – San Francisco, Los Angeles and Miami – have 1985 surpluses that had crossed the billion-dollar mark by June. "These are the ones that bear close scrutiny," said John M. Walker Jr., until recently an assistant US Treasury secretary.

While cash is flowing into these cities, it is apparently leaving New England communities. The Boston Federal Reserve has sent more cash to New England banks than it has collected from them every year since 1970. Last year, it distributed $2.2 billion more in cash than it received. To investigators, these figures suggest that New England's drug cash is going elsewhere to be laundered.

One of those places, they say, is San Francisco. The first official to notice the surplus of cash there was David Christerson, head of the currency department at the city's Federal Reserve. But Christerson was so preoccupied with how to fit all of the extra cash in his overfilled vaults that he failed to ask where it was coming from or why. He did not even tell Federal Reserve bank regulators who might have started looking for answers as they inspected the region's banks.

"Our concern was the sheer volume of it," Christerson said in a recent interview. "It posed a real problem for us.

"I don't know what's causing it. We don't get down to looking at patterns."

The first concerted effort to look for an explanation did not come until a rainy morning last March at a conference called by the US Attorney's office in San Francisco following publicity about the Bank of Boston's violation of the Bank Secrecy Act. According to several of those who attended, investigators with Customs, DEA and IRS drew up a list of possible sources for the surplus. The Globe's findings bolster their theories.

Miami still tops

Florida, particularly Miami, was high on the investigators' list of sources for illicit cash. That area has recorded the largest cash surplus of any in the nation every year since 1970, climbing to $5.3 billion in 1984, and it is the target of one of the federal government's largest financial probes. As a result, dozens of people previously convicted on drug and laundering charges in Miami have moved their operations to San Francisco.

One criminal connection between the two cities involved the case of Miami accountant Ramon Milan-Rodriquez. In one of their biggest busts to date, federal agents arrested Milan-Rodriquez in May 1983 for laundering hundreds of millions of dollars in drug money. Five days later, when they tried to question one of his San Francisco partners, Ivan Cuartas, they found Cuartas had packed up his family and disappeared. Left behind were carbon copy receipts that officials said indicate Cuartas had been receiving blocks of cash from Miami and converting them into cashiers' checks at Bay area banks.

The man who left $6 million in the rented car also had Florida ties. According to a federal affidavit, he gave an alias, Stephen R. Harrison, when he deposited $5,000 at State Street Bank and Trust and received his VISA card in February 1984.

Soon after, charge slips show, he turned up in Florida. From then on, he made several cross-country trips before abandoning the car in San Francisco. He then returned to Miami, where authorities believe he lives today.

Government statistics support what cases such as these suggest, that part of San Francisco's excess cash is coming from Miami.

Federal Reserve figures, for instance, show that the two cities' surpluses have moved in counterpoint to each other for the last 15 years – when one has grown, the other has shrunk. The figures show that excess cash in Miami increased fivefold from 1970 through 1980 while San Francisco consistently ran a deficit. Then in 1981, the tables were turned. Miami's surplus, though still huge, shrank $200 million while San Francisco found itself for the first time in a decade with an extra $500 million. Since then, the surplus in Miami has resumed its growth, but at a modest four percent, while the San Francisco surplus dipped and then doubled.

The same kind of counterpoint movement has occurred with large cash transactions in the two areas during the last five years, according to Treasury Department statistics. The figures show, for example, that the amount of money Florida banks reported collecting in large cash deposits dropped 25 percent during the early 1980s and then resumed its growth, but only at a modest rate until very recently. By contrast, large cash deposits in the San Francisco area banks have jumped fivefold during the 1980s.

"I'd say there are shifts [of cash] from traditional areas like Miami" to the San Francisco Bay area, said William Ferris, DEA's financial investigations chief.

San Francisco is also attracting untold millions in cash from foreign lands like Mexico, the Philippines and Hong Kong. Although there are more legitimate reasons for cash coming from some of these areas than from Miami, investigators still suspect that part of the money is illegal.

By far, the biggest cash source is Hong Kong.

Treasury figures show that in the last five years alone the amount of cash flowing from the British protectorate to the United States has jumped tenfold to more than $1.7 billion. Almost 70 percent of that amount has gone directly into the Bay area.

Because Hong Kong's secrecy laws block their attempts to obtain bank records, US analysts cannot easily determine how much of this cash is illicit. But they say that the recent expansion of the Far Eastern heroin trade has attracted illegal dollars to Hong Kong and turned the city into an international center for drug money. According to the President's Commission on Organized Crime, 65 percent of the currency that is then sent from Hong Kong to the United States is in the small denominations typical of drug traffic.

As one top legal official in Hong Kong put it: "We're the third largest financial center in the world, and at least that large of a laundering center."

US Justice Department officials say they see increasing links between Hong Kong banks and American drug traffickers. "It's obvious to us we'll be doing a lot more business with Hong Kong," said Philip White, who is in charge of collecting information from foreign countries for US criminal investigations.

Government officials raised suspicions about laundering connections between Hong Kong and the Bay area when they announced a $2.25 million fine last month against Crocker National Bank of San Francisco. Crocker was penalized for failing to report $3.4 billion worth of cash transactions with six Hong Kong banks. Two of those six banks collapsed recently; the manager of one of them was caught trying to leave Hong Kong with $154,000 in US dollars and $1.4 million in securities in his briefcase.

Crocker executives were "outraged" by the allegations of laundering. They and other US bankers who do business with Hong Kong say they only take cash from correspondent banks there and cannot be responsible for the original source of the money. The US bankers say they cannot be blamed if their correspondent bank accepted drug cash.

"This is not a business that we talk about. It's something we feel that is part of our business, and not something we want to be advertising," said Thomas Robards, treasurer of Republic Bank of New York. Republic deposited $760 million with the San Francisco Federal Reserve last year, almost all of it from correspondent banks in Hong Kong.

These cash flows from Miami and Hong Kong sources explain where much of San Francisco's excess cash is coming from. But they don't explain why launderers and others are attracted to the Bay area. Investigators cite three reasons: the structure of California's branch banking system, the failure of Bay area banks to report all large cash transactions, and the willingness of some Bay area businesses to accept payments in cash, even in large amounts.

The region has so many bank branches that it is easy for money launderers to hide large cash transactions by spreading them among branches. California's commercial banks alone have more than 4,500 branches, three times the number in Massachusetts. So launderers find it easy to break up large blocks of cash into smaller amounts and buy cashiers' checks under $10,000 at many branches. This technique, known as smurfing, enables them to avoid the government's cash reporting requirement.

Incidence of smurfing is on the rise in the Bay area, according to investigators. In one case, for example, authorities broke up a ring of 35 Colombians who went from bank to bank buying cashiers' checks for just under $10,000, then stuck them inside the covers of stereo records and mailed them to their homes in Colombia. Investigators said one member, Reynaldo Suavita, escaped but was recaptured last July in Boston; he is now awaiting trial.

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The sale of cashiers' checks is also growing, according to the Globe study. Bay area banks reported a 30 percent increase in sale of checks over $10,000 between 1980 and 1984. By contrast, Florida banks reported a 30 percent drop.

If bank branching helps smurfers, banks' failure to report their large cash transactions helps all types of launderers. Bay area banks often fail to report cash transactions above $10,000, according to the Globe study. Investigators say that this is the single biggest problem they face in trying to stop laundering.

The Globe's analysis shows that Bay area banks did not report one quarter of all their large cash transactions in 1984, leaving government probers without any information about the source or use of roughly $1 billion in cash.

The reporting record of Bay area banks was considerably worse than that of banks in other major financial centers, especially Miami. Government officials believe their crackdown on money laundering in Miami has caused banks there to do a better job reporting their large cash transactions than anywhere else in the nation.

According to the latest statistics, Miami banks filed reports on 70 percent of all the cash available in their region. Banks in several other regions filed reports on about 35 percent of the available cash. By contrast, banks in San Francisco have filed reports on only 25 percent of the cash in their area.

Without cash reports, the government cannot identify which businesses are involved in major cash transactions, or whether they are being used by criminals and drug traffickers to launder money.

However, a Globe study shows that several Bay area business groups, whose counterparts in other cities have been susceptible to money laundering, are conducting large cash transactions with increasing frequency. For example:

- Lawyers in San Francisco received $2.7 million in cash fees last year, nearly 70 percent more than they collected in 1980.

"It's not at all unusual or uncommon for defense attorneys to be paid in cash," said Thomas J. Nolan, a Palo Alto lawyer and secretary of a California association of defense attorneys. "I don't go around questioning the people who pay me."

Not all of the cash that lawyers receive comes in the form of fees. Several weeks ago, a Berkeley attorney was indicted for allegedly helping dispose of the cash profits of a drug ring that smuggled 113 tons of marijuana.

- Bay area auto dealers collected almost $7 million in cash for car sales last year and another $3.4 million early this year. Their large cash use, the figures show, has climbed almost 80 percent annually for the last five years.

William Graham, an executive of one of San Francisco's largest dealerships, recalled selling a car for $13,000 cash in 1984 to a man he suspected of being a drug trafficker. The sale produced an unusual aftermath: one of his employees noticed the payment, followed the buyer home, tied him up and stole another $40,000 in cash from him. The buyer untied himself and shot the employee, who subsequently disappeared, Graham said. No charges were filed.

- Real estate brokers in San Francisco received $7.2 million in cash in 1984 and another $1.2 million by March of this year. One Chinatown real estate dealer, for example, said he received $400,000 in cash from a recent immigrant from Hong Kong as down payment on an apartment building. To hide his wealth, the immigrant had stored the money in three safety deposit boxes rather than placing it in an interest bearing account.

The widespread use of cash, typical of San Francisco's Oriental and Filipino communities, complicates the government's task of keeping tabs on the business world. Businesses with whom these communities deal are becoming so accustomed to taking huge amounts of cash that they rarely ask questions about their source.

US Justice Department officials say they see increasing links between Hong Kong banks and American drug traffickers.

Some companies go so far as to advertise their clients' cash wealth in the Yellow Pages. "We have Chinese Buyers with large amounts of cash to invest in income properties, large and small," states one real estate agency's ad. "They seek Commercial Buildings, Shopping Centers, Apartments, Flats and Homes, locally and nationwide."

These transactions should come to the government's attention when they are reported by the financial institutions where the businesses bank. Then, investigators could determine whether they involved money laundering.

But because Bay area banks are failing to report so many cash transactions, investigators know that they could miss cases of laundering. So their first priority is to track down banks that are failing to file the reports. They are planning to borrow a tactic from the Bank of Boston case: zeroing in on banks that file few cash reports but then make huge dollar deposits with the Federal Reserve.

However, investigators admit that it will be a year or more before they can target those institutions. They must wait until the Federal Reserve improves its record-keeping. Currently, the Fed only knows that it is receiving billions more in cash than it used to. But it can't figure out how much each bank is contributing to the excess because its only records are deposit tags from the bags in which the money is brought in.

As the cash was piling up in the vaults this spring, the Federal Reserve tried to sort out the deposit slips into piles for each bank. But its top examiner said, "We looked at the slips and decided we could count all day long and couldn't do anything with what we had."

NEXT: *Bank of Boston*

This report was prepared by The Globe Spotlight Team, which consists of editor Stephen A. Kurkjian, reporter Daniel Golden, economics reporter Peter G. Gosselin, and researcher M.E. Malone. Also contributing was Chris Mauer of the Globe's Information Services department.

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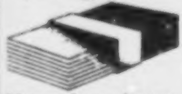
More cars, houses, legal services being bought with cash

Spotlight ☐



Money Laundering

Dick Conway of Sea Crest Cadillac-Pontiac Inc. in Lyon has noticed the upswing: more people are paying for cars with large amounts of cash.

A few weeks ago when a customer plunked down $13,000 in bills as down payment on a fleet of limousines, Conway took it but was worried. Where would he put it for safe-keeping until he could take it to the bank?

Worried or not, Conway and executives like him across the Commonwealth and the country report they are dealing in ever larger blocks of cash. Last year alone, American businesses reported handling $29.2 billion in amounts over $10,000.

That figure is based on a computer analysis of more than five years of cash statistics obtained by The Boston Globe under agreement with the US Treasury Department and the Federal Reserve Board.

These statistics are of growing interest to federal investigators who hope to use them to catch money laundering and to state revenue officials who see them as a means to track tax evasion. They also intrigue some economists who think they can be used to study the effect of cash on inflation and on the nation's overall economic performance.

In Massachusetts, businesses' use of cash since 1980 has climbed at a pace that even surprises some industry spokesmen. But the cash record of Bay State businesses is dwarfed by that of their counterparts in Florida and California. Businesses in those two states reported depositing or withdrawing $8.4 billion in large cash blocks last year, up 60 percent from 1980. They alone account for almost one-third of large cash transactions by businesses nationwide.

Huge cash increase

Some of this increased cash reporting is the result of improved compliance with the 1970 Bank Secrecy Act, which requires banks to file reports on transactions over $10,000 with its customers. But much of it reflects a real rise in the amount of currency paid to businesses.

The Globe examined large cash use by three types of businesses and professions in Massachusetts – auto dealers, lawyers and real estate brokers – and compared it to use by similar groups in Florida, California and the United States.

The study found that Bay State auto dealers reported collecting $8.7 million in more than 400 cash transactions last year. Although that was less than one percent of their total sales for the year, it was still a 20-fold increase over what they reported collecting in 1980. Figures for 1985 show that the amount is still increasing; by the end of March, it had already reached $5.9 million.

Conway and his colleagues were surprised by these figures. "We don't normally get many one-person, over-$10,000 transactions," the Sea Crest executive said. "We much prefer bank or certified checks."

But Conway said he has to accept cash. Otherwise, he said, the customer "will go next door and purchase it there."

Massachusetts lawyers reported receiving $2.9 million in 110 cash transactions last year – less than one percent of the almost $1 billion they collected in fees. Their use of large blocks of cash increased about 1½ times between 1980 and 1984 and has continued to rise this year. By the end of March, they reported receiving another $750,000.

Lawyers said in interviews that clients who would usually pay cash include husbands and wives in divorce cases, and grandparents who dig out their life savings to pay for counsel for grandchildren accused of crimes. But they acknowledged that in recent years, most of their cash has come from another brand of client – the accused drug dealer.

"It's drug defendants paying cash, no question about it," said Beryl W. Cohen, a veteran Boston attorney, "but drug defendants have a right to be represented in court too."

Cohen said some lawyers offer lower rates to clients who pay cash. "It's almost as if the duffel bags [of cash] are being passed straight to the lawyers."

$2.5m in real estate

Massachusetts real estate brokers reported being paid $2.5 million in cash last year. That was a small percentage of their $12.4 billion in revenues for the year. Still, their use of large blocks of cash has more than doubled since 1980. By March of this year, they had reported another $1.4 million in cash payments.

Real estate industry leaders seemed nonplussed by the cash figures. "If somebody paid currency for a house, word of it would go through this company in 10 seconds," said John Bond, an executive with Jack Conway & Co., a Massachusetts real estate firm. "In 15 years I've never heard of it happening."

"We don't deal in cash in any transaction," said Joseph L. Delaney, a Milton Realtor. "Most brokers... do not have the necessary security" to deal with it.

The use of cash in Florida and California is far more common than in Massachusetts. The real estate brokers, lawyers and auto dealers in these two states account for one-third to one-half of all large cash transactions that their occupational groups reported conducting nationwide last year.

Florida auto dealers reported receiving $160.7 million in large blocks of cash last year, or nearly two percent of their sales. California dealers collected another $54 million.

Auto dealers in both states acknowledged accepting some cash payments for cars. Morry B. Markowitz, an executive with one of Miami's largest dealerships, Braman Inc., said his firm "sees a fair amount [of cash], a little more perhaps than elsewhere." He said the reason was that Braman's customers are older people with large amounts of disposable income.

However, one of Markowitz's salesmen, Ogie Royce, told a different story. Royce said that Braman's cash sales have dropped 80 percent since the start of the year when the government tightened cash reporting requirements for auto dealers, driving away customers he suspected of being drug traffickers. Their cash purchases "just stopped," he said.

Florida real estate brokers reported being paid $59.8 million in more than 2,300 large cash transactions last year. Their California

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colleagues received another $18.9 million in almost 1,000 deals.

Among these professions, the lawyers do the largest portion of their business in cash. Last year, Florida lawyers reported collecting $68.9 million – or six percent of the estimated $1.1 billion they made – of their fees in cash. California lawyers collected $10.5 million in cash fees. The combined cash use by lawyers in the two states accounted for more than 46 percent of large cash transactions reported by lawyers nationwide.

Neal R. Sonnett, vice president of the National Association of Criminal Defense Lawyers, said that Florida attorneys are paid in cash more often than lawyers in other states because 60 percent of defendants in federal cases in southern Florida are suspected drug dealers. "For active criminal practitioners . . . being paid in cash certainly doesn't surprise me," he said.

"I never thought there was any impropriety in accepting cash for anything in America," said Richard A. Sharpstein, president of the Florida Criminal Defense Attorneys Association. "When people come to hire me, I assume them to be innocent."

But investigators believe that many of the large cash transactions by businesses in Florida and California include illicit money. Even in Massachusetts, where such transactions are less common, a top Revenue Department official said he thinks some businesses may be using cash to evade taxes and underwrite elaborate criminal schemes.

Latest scams here

"Massachusetts has the economy of the future," said Revenue Commissioner Ira A. Jackson. "It is only logical to believe that the latest and more sophisticated of scams with money would be taking place here."

Some economists are also showing concern about the figures. Until recently, economists paid little attention to currency because Americans pay for their most of their goods and services with checks and credit cards, not cash. Cash makes up only about 28 percent of the money supply.

But the cash statistics now being assembled under the Bank Secrecy Act indicate that Americans use cash very differently than economists had assumed.

Traditionally, it was thought that people only used cash to pay for smaller items like groceries and newspapers. It was also thought that when people had cash in their pockets, they spent it right away, because it is readily accepted as payment.

However, the government's figures suggest that Americans hoard a lot of their cash. And when they do spend it, they often pay for big items such as attorneys' fees, cars and houses.

Economists say that trying to explain these trends is important in order to design policies to keep the economy healthy and growing. A study by former Boston Federal Reserve economist Ralph C. Kimball concluded, "Recent trends in currency usage have made the formulation of monetary policy more difficult and created uncertainty" about the spending habits of Americans.

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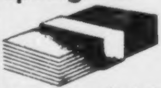
Spotlight ☐



Money Laundering

Bank ignored auditor's warning

Third in a series

Late in 1977, a deputy auditor at the Bank of Boston discovered a problem: tellers at the bank's branches did not understand a federal law requiring them to report large cash transactions.

But two vice presidents who were told of the auditor's finding either minimized or misinterpreted it, according to confidential memos obtained by The Boston Globe Spotlight Team. The result was that the auditor's boss sent a memorandum to the bank's two highest officials – Richard D. Hill and William L. Brown – informing them that tellers did understand the cash reporting law.

This failure to heed the auditor's finding was crucial, because no other internal probe would catch the problem until it was too late. The bank pleaded guilty to violating the cash reporting law last February, eight years after the original warning. The bank paid a $500,000 fine, which at the time was the largest ever assessed for breaking the reporting law.

The bank also was forced to concede that two real estate companies controlled by organized crime figure Gennaro Angiulo had been placed on a special list exempting their cash transactions from being reported to the Internal Revenue Service. Like many other banks around the country, Bank of Boston had become a conduit for the illicit cash that criminals seek to move into the legitimate economy.

The documents obtained by the Globe also show that Bank of Boston had far more extensive problems with its exempt list than simply the Angiulo companies.

For instance, the bank's internal auditors never checked whether companies on the list should have qualified for exemption from the Bank Secrecy Act, which requires reporting of cash transactions above $10,000. As a result, the US Treasury Department had to order 30 companies removed from the list after a review in 1983.

Among these companies were at least five, not including Angiulo's firms, that had no apparent reason for making regular cash transactions above $10,000. Whether any of those companies were used to launder money has not been revealed. The bank refuses to discuss any of the documents, which were assembled by its staff to prepare for its defense.

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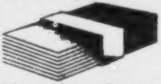
Bank of Boston ignored warning eight years before guilty plea

Giving low priority to reporting law, many banks are conduits for dirty cash

Spotlight ☐



Money Laundering

■ SPOTLIGHT
Continued from Page 1

The bank also set unrealistically high ceilings for many exempted firms that allowed cash transactions far above their normal business levels to go unreported, a violation of Bank Secrecy Act regulations. After the Treasury Department's review, the bank had to reduce these limits.

One exempted company was the Boston law firm headed by prominent attorney F. Lee Bailey.

The bank gave Bailey's firm the right to make unlimited cash transactions that would not be reported.

"Some degree of our fees have always been and still are paid in cash," Bailey's partner, Kenneth Fishman, said in an interview. "Anybody in the practice of criminal law tends to get paid fees in cash."

Fishman said that the firm refused cash from clients only if they stated that it was obtained illegally. Otherwise, he said, "The question is never asked. It's just like other businesses. If you buy a car with cash, the dealer doesn't ask where it came from."

The confidential documents do support the Bank of Boston's contention that no bank employee financially benefited from its wrongdoing. In a July report, its board of directors blamed "widespread laxity and poor judgment" inside at least six of the bank's divisions as the cause of the problems. The report did not identify the employees at fault.

In all, 35 banks have been prosecuted for failing to comply with the Bank Secrecy Act. In most cases, the reason is not overt corruption, but the low priority given to the cash reporting law, and the reluctance of bankers to police their customers.

"Probably nine out of 10 banks fail to comply with the act in some respects, out of negligence and inadvertence," said Jeffrey Harris, a former deputy associate attorney general who has recently explained the law to bankers at seminars around the country. "They might file the reports, but then they have a problem with the exempt procedures."

"Fierce competition" between banks for deposits leads to many violations, Harris said. Since criminals are not seeking a high interest rate, their deposits are especially attractive to banks. "When bankers get an opportunity for cheap money, it's hard for them to ask tough questions," Harris said.

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Shawmut probed

In one case now being investigated by the US Attorney's office in Boston, a South Shore affiliate of the Shawmut Bank of Boston did not ask enough tough questions. The investigation centers on an attempt last fall to ship more than $1 million worth of munitions to the Irish Republican Army aboard a Gloucester-based vessel, the Valhalla.

The bank received $550,000 in cash deposits from a Braintree man during a week in March 1984, but it failed to file reports on $250,000 of the money, according to sources familiar with the case. Shawmut-Needham's Braintree branch accepted the deposits without further inquiries after a regular customer assured a bank supervisor that the Braintree man was a "good guy."

In fact, the Globe has learned, at least $77,500 of the money deposited in the branch wound up with a convicted drug dealer whose brother is under investigation for allegedly masterminding the munitions shipment. The US Attorney's office, according to sources, is seeking to determine if any of the cash that went into the bank was ultimately used to buy the weapons.

In the same case, investigators are exploring why that Shawmut-Needham branch did not report other deposits totaling several hundreds of thousands of more dollars into the Braintree man's corporate account. Since none of these deposits exceeded $10,000, the branches may not have violated the law, but because they were made with such frequency over a few months in 1984, investigators contend that the bank should have become suspicious and reported the activity to authorities.

Investigators in the case have also subpoenaed records from Patriot Bank, Braintree Savings Bank and Bank of Boston.

One official, who though familiar with the case asked not to be identified, said he doubted the investigation would show that any bank officials had willfully failed to report the transactions. "These things took place before the Bank of Boston was publicized," he said. "No one was paying proper attention then."

Corrupted bankers

Still, because criminals can pay them so much money, there have been some cases where bank officers have been bribed to avoid reporting cash transactions.

Earlier this year, an FBI sting operation led to charges against 14 current and former bank officials in Puerto Rico for conspiring to launder drug money. Among those indicted was Raul Enrique Pengaricano-Soler, president of the Caribbean Federal Savings Bank, who failed to disclose a deposit of $385,000 in cash by an FBI agent posing as a money launderer. Pengaricano-Soler is also a member of the federal board that oversees all savings and loan institutions in New York, New Jersey and Puerto Rico.

While many banks have security officers to check for compliance with the Bank Secrecy Act, these officers must monitor a wide range of other regulations as well. In practice, responsibility for enforcing the act is often up to tellers who have not been adequately instructed in its provisions. The President's Organized Crime Commission reported last year that banks usually devote less than one hour to teller training on compliance with the act.

Even when trained, tellers may not report cash transactions properly, bankers said. For one thing, they have many other responsibilities, from counting money to scrutinizing check endorsements. They are badly paid – usually between $8,000 and $20,000 per year. They change jobs frequently; one banker estimated that turnover among tellers is 20 percent a year.

William Brown

The Bank of Boston case drew bankers' attention to the cash reporting law. Since then, the number of transactions reported to the federal government has doubled. More than 40 other banks nationwide have informed the Treasury Department that they too had accepted millions of dollars in cash without reporting the transactions. They include Shawmut and Bank of New England.

Bank of Boston's audit department reviewed its compliance with the law in 1977. Although it identified only one transaction where the bank failed to file a report, deputy auditor Perley A. Swasey Jr. sounded an ominous note.

"The prevalent weakness. . .was that tellers and teller trainees at the branches we reviewed had not been informed of Operational Procedure. . .Although Branch Management was aware of the Bank Secrecy Act, and possessed written procedures in the new Retail Banking Operating Manual, it appears that tellers weren't aware of proper procedures."

Swasey's report was sent to Robert L. Stearns, vice president of Banking Offices Administration, which oversees the bank's branch offices. A short time later, Stearns responded to Swasey's criticisms in a memorandum to his boss, John F. Stucke, vice president in charge of the bank's audit department. Stearns said a new manual being drafted for tellers would include instructions for complying with the act.

Warning unheeded

Stearns stressed that the bank's exposure to mistakes was limited because tellers could only cash checks up to $1,500. Therefore, he reasoned, the only cash transactions above $10,000 in which tellers had direct responsibility would be deposits.

However, Stearns' memo did not take into account that money laundering usually occurs – as it did with the Anguilos – when a customer uses cash to buy cashier's checks from the bank, instead of making deposits. Tellers had responsibility for selling bank or cashiers' checks above $10,000.

Stearns declined to be interviewed.

Two months later, on June 1, 1977, Stucke informed Hill, the chairman of the board, and Brown, the president, that his division had examined compliance with the Bank Secrecy Act. "Overall, everything appeared to be satisfactory," Stucke wrote, "and tellers and managers were aware of and conforming to the provisions of the act."

In July 1980, Congress authorized the Treasury Department to tighten the Bank Secrecy Act. One of the major changes in the law was that cash transactions with foreign banks now had to be reported.

That year, Daniel M. Dormer took over as vice president in charge of Bank of Boston's Coin and Currency division, which was shipping hundreds of millions of dollars to and from European banks each year. Dormer was notified of the change in the Bank Secrecy Act, but did not recognize its significance because he was so new in the job. This oversight would prove critical in the bank's failure to report $1.2 billion worth of transactions with Swiss banks between 1980 and 1984.

Nearly two years later, Dormer received a notice from the bank's Systems Research Department updating procedures for reporting domestic cash transactions. But the memo did not mention the reporting requirement for shipments of money to and from foreign banks.

Dormer did not learn until 1983 that the bank had been supposed to report the transactions. US officials initially thought that the bank had been laundering dirty money overseas, but later acknowledged that the reporting failure had been an innocent mistake.

As it turned out, the bank was more deeply embarrassed by revelations about its relationship with two companies controlled by Gennaro Angiulo and his brothers. The Angiulos had begun commercial banking with the bank's North End branch in 1964. Between 1979 and 1983, Huntington Realty Co. Inc. and Federal Investments Co. obtained more than $7 million worth of cashiers' checks from the bank. More than $2 million worth of the checks were purchased with cash in amounts above $10,000 apiece and should have been reported to the IRS. The conversion of cash into cashiers' checks is a favorite laundering device of organized crime figures, exactly the type that the Bank Secrecy Act was enacted to monitor.

But the bank did not report any of the transactions; it had placed both companies on its exempt list. Arguably, the exemption for Angiulo's two companies was technically appropriate under the law's original language, which permitted exemptions for any bank customers who regularly dealt in large amounts of cash.

However, the tightened Bank Secrecy Act in 1980 included a restriction on the types of companies eligible for exemption. They could only be retailers, and even then they could only be exempted if the size of their business

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> 'Probably nine out of 10 banks fail to comply with the act in some respects, out of negligence and inadvertence. They might file the reports, but then they have a problem with the exempt procedures.'
>
> – Jeffrey Harris, a former deputy associate attorney general

justified the amount of their cash transactions.

News of the change reached Bank of Boston in July 1980, and within days the Banking Administration division sent a memo to the branches. "Each office should submit new letters listing customers who are exempt from filing large currency transaction reports," stated the memorandum from Stoddard G. Colbert, vice president in charge of the division. To coordinate the effort, he placed his assistant Hubert W. Cox in charge.

11 on North End list

Two weeks later, North End branch manager Gloria Cushing sent Cox a list of 11 companies she considered eligible for exemption. They included Angiulo's companies, plus Caiola Travel Agency, European Restaurant, Francesca's Restaurant, Home Savings Bank, Mike's Pastry Shop, Modern Pastry Shop, the Social Service Credit Union and Louis Triulzi's jewelry store, all of the North End; and A. Pellegrino & Son's produce center in Chelsea. Only three of these companies were still on the list after the Treasury Department's review in 1983.

Cushing, who retired from the bank in January, refuses to be interviewed. In a statement released by her attorney in April, she said she believed that the two Angiulo companies qualified for the exemptions. In testimony before Congress earlier this year, Brown criticized her for using "poor judgment" in the matter.

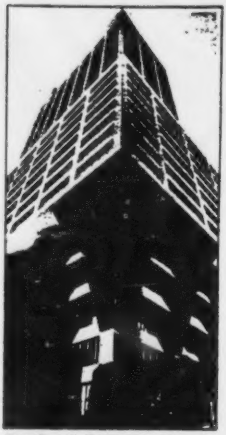
Although Cox compiled a central exempt list from the names submitted by the different branches, he did not screen the companies to see if they qualified under federal guidelines.

In addition to finding that one-fourth of the companies on the bank's exempt list should have been ruled ineligible, the Treasury Department's 1983 review also indicated that many companies on the list were given cash limits that exceeded their normal business needs – or that had no limits at all. The bank had given 22 companies authority to deposit any amount of cash without a report being filed to the federal government, in violation of the law.

After the Treasury Department's 1983 review, the bank would set new limits for exempt transactions for many companies on the Bank of Boston's list. For example, the Union Oyster House went from unlimited cash deposits to $20,000; Lord and Taylor, from unlimited to $120,000; Brigham and Women's Hospital, from unlimited to $17,000; Arthur D. Little, from unlimited to $40,000; and Mike's Pastry Shop, in the North End, from $60,000 to $20,000. The ceiling on unreported cash transactions by The Boston Globe, which is also on the exempt list, was reduced from unlimited to $500,000.

These new limits marked an end to the bank's casual treatment of its exempt list. Until 1983, according to interviews, the bank's priority was the convenience of its regular customers, not the investigative needs of the federal government.

As one businessman explained when asked why the bank had granted unlimited status to his company: "I may have said, 'Listen, I don't want a limit if I can avoid it.' They probably said, 'He's a good customer. As a service, we won't put a limit.'"



Bank of Boston's downtown building.

NEXT: *Government's failings*

This report was prepared by The Globe Spotlight Team, which consists of editor Stephen A. Kurkjian, reporter Daniel Golden, economics reporter Peter G. Gosselin, and researcher M.E. Malone.

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After US review, bank cut 30 firms from its exempt list

Two companies controlled by reputed crime boss Gennaro J. Angiulo and his brothers were not the only ones improperly placed on the Bank of Boston's exempt list.

The bank had to drop as many as 30 of the 102 companies on its list in 1983 after the US Treasury Department found that they had wrongly been given exemptions from a law requiring cash transactions over $10,000 to be reported to the government.

Late last year, the Boston Globe has learned, the principals of several companies that had been removed from the exempt list were called to testify before a federal grand jury. Like the Angiulo-controlled firms, these companies had accounts at the Bank of Boston's North End branch.

According to several sources, prosecutors in the case were trying to determine if any of the companies had gotten on the list through illegal means, or whether they had laundered any illicit cash through their transactions at the bank. No indictments were returned.

Bank of Boston spokesman Barry Allen refused to say recently whether two probes done by the bank itself had found if any companies on the exempt list besides the Angiulos' Federal Investments and Huntington Realty may have been laundering money. "That's an interesting question," Allen said late last month. "Unfortunately all of the companies on the exempt list were our customers, and their business with us is confidential."

However, the Globe Spotlight Team has obtained copies of documents showing the bank's exempt list at various times between 1972 and 1983. At least five companies appear particularly unsuited to the list. Bank officials were supposed to grant exemptions only to companies that regularly had cash transactions above $10,000, yet these five firms are not generally considered retail or cash businesses.

In addition, their owners either denied dealing in large amounts of cash, or would not reveal the sources of the money. Some of these companies have had associations with white-collar criminals or organized crime figures. The five were:

STABILE TRAVEL AGENCY: Stabile and Co. Travel Agency Inc. on Hanover Street was on Bank of Boston's exempt list from 1977 to 1979. Travel agencies usually conduct business by check, but John Grossi, owner of Stabile, had a sideline: a currency exchange business.

Grossi told his customers that he could send their dollars to an Italian bank. The money would be converted to lira at an advantageous exchange rate and earn high rates of interest, while being shielded from American taxes.

Although Bank of Boston must have regarded Grossi's service as legitimate, it was in fact a hoax. Grossi kept the money instead of forwarding it. After allegedly stealing $500,000 from his customers, he fled to Italy in 1979. He also left behind debts of $24,000 to Bank of Boston, which had loaned him $50,000 that summer, and $37,000 to airlines that he had not reimbursed for ticket sales.

A warrant was issued for Grossi's arrest on charges of larceny by false pretense. He has never returned to stand trial. Today, Stabile Travel remains closed. Through its windows can be seen outdated travel brochures and maps.

F. LEE BAILEY: The only law firm on the Bank of Boston's exempt list in 1982 was the office of F. Lee Bailey, whose clients have included Patty Hearst and Albert DeSalvo, the "Boston

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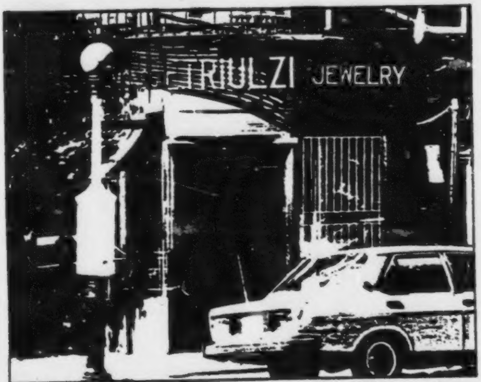

Triulzi Jewelry store, two doors from Bank of Boston's North End branch.

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No explanation for firms on exempt list

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Strangler." The bank permitted the firm to make unlimited deposits without any reports being filed to the federal government. The firm was struck from the list in 1983 by the US Treasury Deparment because it does not consider law firms as retail businesses that customarily deal in cash.

Bailey has defended several clients, including Joseph Barboza and Peter Limone, who have been described in court records as associates of Gennaro Angiulo, reputed head of organized crime in Boston. Angiulo, who controls two real estate firms that were on the bank's exempt list, was reported to have met with Bailey in 1983 to discuss hiring him as counsel. Angiulo is currently on trial in Boston on federal racketeering charges, but Bailey is not representing him.

But a member of Bailey's law firm recently represented Angiulo in a real estate transaction. Mario Misci aided Angiulo in gaining control of a Revere marina and protecting it from forfeiture by the federal government.

Bailey refused to answer numerous calls to his office. His partner, attorney Kenneth Fishman, said the firm was probably placed on the list in 1975, when it opened an account at Bank of Boston. He said Bailey had not been aware of the firm's exempt status, but was not surprised by it.

Fishman said that Bailey only received "fee-related" cash from his clients. But he declined to state exactly how much cash the firm deposits each year or to name clients who paid cash.

If Bailey's firm had not been on the exempt list, Fishman said, bank reports on its deposits over $10,000 might have aided law enforcement efforts. "If a lawyer enters an appearance in a case in a certain week, and he shows significant cash deposits in that week, it might be a step in the investigative process," he said.

A. PELLEGRINO & SON: The last time that A. Pellegrino & Son did a significant cash business was when it sold wine grapes in the 1960s, according to former owner Joseph Pellegrino. Yet the wholesale firm in the New England Produce Center was on Bank of Boston's exempt list from 1979 to 1982, allowed to deposit $50,000 in cash without any reports being filed.

Pellegrino, who ran the business from 1977 until this year, said he had no knowledge of the firm's exempt status until he was subpoenaed last fall by the grand jury. "Ninety-nine percent of our business was checks," he said. Pellegrino said he knew North End branch manager Cushing, but there had been a "personality conflict" between them.

The firm had no known organized crime ties during the years it was on the exempt list. But in September 1983, when the company had been losing money for two years, Pellegrino hired Marvin Karger, a self-described "financial expert."

F. Lee Bailey

The new vice president and comptroller had a long record of white-collar crime, according to documents filed in US District Court. Karger had pleaded guilty in 1970 to receiving and disposing of stolen Treasury certificates valued at more than $1 million, and served four years in prison. He later spent another year behind bars after being convicted of passing bad checks. Pellegrino said he and Karger met at some point after 1980 when Karger was on work release from Suffolk County jail and had a job at another produce company.

A. Pellegrino & Son filed for Chapter 11 reorganization in November 1983. A year later, the court approved a plan in which Karger's brother Peter, who runs a North Shore vending company, would lend $600,000 to the firm on the condition that Karger remain as one of its executives.

During the proceedings, A. Pellegrino & Son filed this affidavit: "Many law enforcement authorities consider Mr. Karger to be a notorious white-collar criminal with connections to organized crime. Since joining the company, management believes that Mr. Karger has made several significant contributions and has succeeded in bringing weekly operating cost under tighter control."

SHARKEY'S MEAT PACKING: A small meat market that catered to a few local restaurants is how long-time North End residents remember Frank Calabraro's Sharkey's Meat Packing Co. Inc. Since Calabraro closed down his storefront operation around 1973, he has run his business out of his West Quincy home, selling meat that he had bought wholesale to selected customers.

"He's a small meat jobber," said one competitor. "I think he has one truck and he does a little business that way, adding a few cents onto every pound he delivers."

Documents filed by Calabraro with the secretary of state's office also reflect the modest size of the business. The company's total assets ranged between $35,000 and $67,000 in the mid-1970s. The last two financial reports the company filed, in 1977 and 1978, did not list any figures for its assets or liabilities.

The landlord of the building that Sharkey's occupied in the North End said he was surprised to hear that its cash business would have been large enough to justify inclusion on the bank's list of large cash customers. "He was one of a several [butchers] in this area, everybody scraped by, nobody got rich," said Carl Caeta.

Yet Bank of Boston considered the company one of its largest cash customers. According to 1982 documents, Sharkey's was authorized to deposit as much as $40,000 at a time, without having the transactions reported to the federal government. The Treasury Department ordered Sharkey's dropped from the list in 1983 because it was considered a wholesale company.

Neither bank officials nor Calabraro would explain Sharkey's presence on the list. "I have nothing to say," Calabraro said recently. "Go to work."

TRIULZI JEWELRY STORE: Located two doors away from the Bank of Boston's North End branch, this store was authorized to deposit $25,000 in cash regularly, according to the bank's 1982 exempt list. Yet owner Louis Triulzi said in a recent interview that he sells only $150 to $300 worth of jewelry per week.

"I don't sell any gold. I'm wasting my time," he said. "My store's closed almost all the time. I don't even have jewelry in the window."

Triulzi said he did not know he had been placed on the exempt list. "Gloria Cushing was a friend of mine, and she must have put me on," he said.

State Police searched Triulzi's store in 1980 because they suspected that his safe contained a stack of stolen $20 bills. No such bills were found. "Somebody said I had bank robbery money," Triulzi said. "That was nothing but a hoax. . . . Somebody was just trying to break my testicles."

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Spotlight ☐

Money Laundering

US failing to catch dirty cash

Mistakes, false starts hobble crackdown

Top law enforcement and political figures told a congressional hearing in Boston last week that drug abuse in New England has reached epidemic proportions. Prosecutors have recently recognized that the only way to stem the escalating supply of cocaine and marijuana is to strike at its financial underpinnings. For the past four months, The Globe Spotlight Team has investigated how drug traffickers and other criminals hide their cash earnings from government scrutiny and launder their profits through the legitimate economy.

Fourth in a series

By the time he was arrested last December, Elmer E. Rodriguez had plowed at least $100,000 of his drug money into a tidy real estate operation that included apartments in Brookline and a three-story brick building at 77 Highland St., Roxbury.

Federal investigators got to Rodriguez in time to catch him with cocaine, drug scales and packaging equipment, enough to convince him to plead guilty in April. On June 17, he was sentenced to seven years in federal prison.

However, investigators failed to show as much dispatch in getting to Rodriguez's property despite laws that officials acknowledge often make it easier for them to go after a criminal's possessions than after the criminal himself.

Sometime in May, five months after his arrest and more than a month after his guilty plea, Rodriguez managed to sell the Highland Street building for $75,000. The new owner told agents who contacted him afterward that he had checked real estate records before buying and found no notice that the government had convicted Rodriguez and might want to seize the building. Officials with the US Attorney's office in Boston now concede that both the building and the money may be lost to them forever.

"We'll miss things lots of times," said a veteran prosecutor with the office.

The loss of 77 Highland St. is part of a pattern of mistakes, false starts, inadequate staff and contradictory policies that have hobbled the federal government's efforts to break the cycle of criminal finance. More than 15 years after Congress passed the first law aimed at attacking criminal money laundering by forcing disclosure of all large cash transactions, the government has yet to get tough. Among the reasons why:

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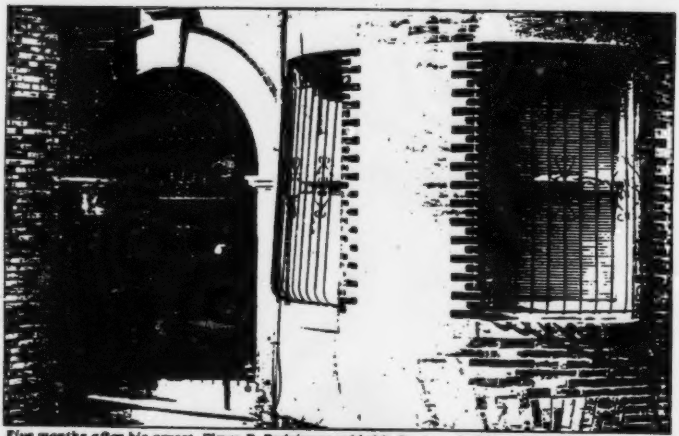

Five months after his arrest, Elmer E. Rodriguez sold this Roxbury building for $75,000.

The Boston Globe 9/25 1984

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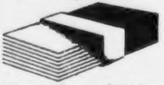
Despite tough talk, US fails to crack down

Federal efforts hobbled by contradictions, false starts

Spotlight ☐



Money Laundering

■ SPOTLIGHT

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- Federal bank regulators, who are supposed to ensure that the nation's banks comply with the cash reporting law, no longer do more than cursory exams at most banks and are sharply cutting both the number of examiners and the number of banks they regularly check.
- The US Treasury Department which is supposed to administer the reporting law, has until recently assigned just one person to the task. Files in a Treasury Department computer that is supposed to study cash reports from banks and other businesses to spot money laundering schemes are so full of holes that some analysts doubt many of the computer's results.
- Five federal law enforcement agencies, including the US Attorney's office, which are supposed to use the computer studies to track down laundering, either fail to get copies of the studies or fail to use them. When investigators do uncover a scheme, they arrest participants, but then seize only their most obvious assets, leaving them with the means to revive their criminal enterprises.

The five agencies have established more than 40 task forces throughout the country to investigate drug trafficking, but insufficient staff has hampered their efforts to trace drug profits. The head of one task force said that it needed twice as many investigators in order to combat money laundering.

"We've got all the pieces for a system to track bad guys' money. What we need is somebody to run it," said an exasperated Charles H. Morley, chief investigator for the Senate Permanent Subcommittee on Investigations, which has issued a stream of reports on international money laundering.

The government has had some successes. This year in Boston, for example, investigators traced, then destroyed, the multimillion dollar financial network of Marshfield drug dealer Frank J. LePere. In Miami, they tracked down a certified public accountant who flew so much criminal cash to Panama that when he was finally stopped in 1983, Panamanian supplies of US dollars dropped by $200 million.

More often, investigators only skim the surface of a criminal's finances. Prosecutors with the Boston US Attorney's office, for instance, won drug convictions against Erwin O. Monsalve this July and seized more than $350,000 he had stashed in safe deposit boxes at the Bank of Boston and the Home Savings Bank in Boston. But they have not been able to do anything about the rest of Monsalve's financial network which they believe stretches from Boston to his native Colombia.

"We know it's out there," said an official close to the case. "We just don't have the resources to go after it."

The criminal financial system should be vulnerable to attack because of its most distinctive feature: it runs almost entirely on cash. Because cash is bulky, conspicuous and inviting to thieves, criminals must launder it into the safer, more manageable forms of bank deposits, stocks, bonds and property. To launder it, the criminals must depend on the bankers and businessmen of the above-ground economy. But when they come above ground, they expose themselves.

Law enforcement officials and legislators recognized as early as 1970 that cash is the weak link in the criminal financial system, and started to do something about it. They won congressional passage of the cash reporting law. And they began to treat investigations that they had originally thought of as straightforward drug or racketeering cases as financial probes. In another era, that might have been enough to ensure a systematic attack on the criminal financial system.

But law enforcement authorities suffered a series of setbacks in the 1970s. The banking industry blocked virtually all financial probes for several years with a blizzard of lawsuits that charged the probes were unconstitutional. Then the Nixon administration appointed an Internal Revenue Service commissioner, Donald C. Alexander, who banned the one federal agency equipped to conduct financial probes from doing any.

Finally, the Watergate scandal persuaded many Americans that government officials would intrude on individual privacy to settle political scores. One of Congress' responses was to pass laws that effectively prohibited financial investigators from talking to each other about what they had found.

"That set us back 15 years," Robert J. Stankey, head of the Treasury Department's financial investigations office, asserted recently. "We're only getting back to where we were in 1970."

Today, the federal government has a three-part system for attacking underworld finances. But it has yet to operate the way it was designed to. It was supposed to work like this:

The first stage involves reporting. The government's five bank regulatory agencies, the Securities and Exchange Commission and the IRS are responsible for ensuring that American banks and businesses comply with the Bank Secrecy Act. The act requires banks and most businesses to file reports with the IRS on any cash transaction involving more than $10,000. It also requires anyone carrying more than $10,000 in or out of the country to report it to the US Customs Service.

The second stage involves analysis. Once cash reports are filed, the Treasury Department is responsible for using them to get a birds-eye view of where large blocks of cash are flowing around the country and the world, who controls them and for what purpose. The department is supposed to produce studies of cash trends based on the reports and distribute them to law enforcement agencies.

The third stage involves investigation. The secrecy act and an asset forfeiture law passed last year by Congress give law enforcement officials the tools to track down the cash movements Treasury Department studies uncover, distinguish which ones are legal and which ones are illegal and then crack down on the illegal ones.

The job of making sure that the whole system – reporting, analysis and investigation – works smoothly is assigned to the Treasury Department because it is the only government agency that deals with both regulators and investigators.

Ideally, the system would give the government the means to crack underworld finances by inserting itself between cash-laden criminals and the legitimate banks and businesses on which they depend for money laundering. But so far it hasn't worked.

Failures uncovered

The General Accounting Office, Congress' watchdog agency, has uncovered failures at every stage of the process. In a series of reports starting in the late 1970s, GAO criticized the failure of regulators to ensure cash reports were filed; the failure of the Treasury Department to produce and distribute useful studies of currency flows based on reports that were filed; and the failure of law enforcement officials to use the studies that were produced.

GAO officials reserved special criticism for the Treasury Department, which they said had failed to make all of the parts of the system work together. "The Treasury Department is primarily responsible for ... conditions (hampering success of the system) because it has not aggressively and effectively implemented the Bank Secrecy Act," a 1981 GAO report concluded.

Following hearings last March on the Bank of Boston case, the GAO was ordered to begin yet another review of the system. Officials who received private briefings its progress this summer said that GAO auditors are turning up many of the same problems they first spotted almost a decade ago.

The problems start with the regulators, especially bank regulators, who are supposed to ensure that American business reports all of its large cash transactions.

In recent years, the federal government's five bank regulatory agencies have suffered substantial cuts in the number of bank examiners they have. To cope with the cuts, the agencies have turned to computers to replace examiners and slashed the number of banks they regularly examine. The result: the regulators cannot ensure that most American banks – the nation's heaviest handlers of cash – are reporting their large cash transactions.

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Figures gathered by the Globe show that between 1980 and 1984 the five regulatory agencies – the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corp., Federal Home Loan Bank Board and National Credit Union Administration – reduced their staffs of examiners by 11 percent. Over the same period, the figures show that total bank assets – the very thing examiners are supposed to check – have increased almost 40 percent.

New England and the Northeast have been particularly hard hit. The comptroller's office, for example, closed its Boston operation in 1983 and assigned Boston-based examiners to New York. Last year, the New York office lost more than 14 percent of its 330 examiners to resignations and retirements. By contrast, the average departure rate among other government agencies is three percent.

Traditionally, regulators sent their examiners into every bank in the country about once a year. "We counted the cash, verified the accounts and checked the assets," said Paul M. Homan, until recently one of nation's top examiners as deputy comptroller of the currency.

However, as the regulators have cut back on examiners, they have also had to reduce the number of banks that they regularly examine. Exact figures are hard to come by. However, from officials' comments, it appears that examiners now check less than 2,000 of the nation's 28,500 banks, savings and loan associations and credit unions on a regular schedule. Examiners may not perform full-fledged exams at any of the other 26,500 institutions for as long as three years at a stretch.

Increasingly, the regulators have tried to replace examiners with computers. By demanding that banks provide them with up-to-date information and by assigning computer analysts to study the information, they hope to catch problems without sending anyone into most banks.

Advocates say that automation allows regulators to do more regulation with fewer people. But the advent of the computer has had an unfortunate side effect: it has made it almost impossible for regulators to check on whether banks are complying with the Bank Secrecy Act.

Computers are not as effective at spotting banking problems as an examiner "on-site inside a bank," Homan said in an interview. So the overall quality of federal bank regulation has "gotten worse and worse. It's just too few people chasing too many problems."

Computers are particularly limited, according to Homan, when it comes to checking a bank's compliance with the government's cash reporting rules. "It's very hard ... as a matter of fact, I don't know how you would examine for cash reporting without being in a bank," he said. "You have to look at the files to know whether they are filing reports. ... You can't check compliance with a computer. It's not possible."

Homan's contentions are supported by the GAO's findings. From the late 1970s on, the GAO has accused regulators of doing no more than cursory cash reporting exams at most banks. In a 1981 report, the GAO said that it discovered one regulatory agency did no formal cash exams at all.

Regulators, caught short by the 1981 report, reacted by saying they did not have enough examiners to do more than cursory checks of cash reporting. So the GAO proposed a compromise: If regulators could not check cash reporting at all banks they examined each year, then they should pick a random sample of 10 percent of the banks and perform checks at those. None of the regulatory agencies has taken the department up on its proposal.

The failure of regulators to examine banks for cash reporting made news earlier this year in the aftermath of the Bank of Boston case. Under congressional grilling, then-Comptroller C. Todd Conover acknowledged that his examiners had failed to spot more than $1.22 billion in large cash transactions that the Bank of Boston conducted with foreign banks over four years. Perhaps worse, Conover also admitted that some of his examiners did not even know that a 1980 change in the law required foreign bank transactions be reported.

In the two months following the Bank of Boston disclosures, more than 50 banks, including at least eight of the nation's largest 25, notified the Treasury Department that they too had failed to report many large cash transactions. Department officials say the regulators missed the reporting problems in all but a handful of cases. (A notable exception was Crocker National Bank in San Francisco where comptroller examiners discovered that the bank had failed to report almost $4 billion in big cash transactions over four years. The bank received a $2.25 million fine last month, the largest handed out for cash reporting violations.)

The regulators are not the only ones responsible for problems with the government's system for attacking underworld finances. The system's troubles extend beyond ensuring that the banks and businesses file reports on large cash transactions to the analysis of the reports. This is the Treasury Department's special domain.

The Treasury Department, together with Customs and the IRS, which are both divisions of the department, is charged with making sure the government receives all of the information it needs to track large currency flows across the country. And it is supposed to use computers to analyze the information for suspicious trends.

But until recently the quality of information the department was feeding into its computer files was so poor that many analysts believed the computer was incapable of spotting any trends.

In its 1981 report, for example, the GAO concluded that up to 40 percent of cash reports filed by banks and other businesses were either incomplete or just plain wrong. Information as simple as a person's Social Security number was missing on more than three-quarters of the forms studied in one GAO sample. Misuse of abbreviations like "ME" so confused the computer that it sent information about transactions conducted by people living in Mexico to investigators in Maine.

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The GAO recommended in mid-1981 that the Secretary of the Treasury order department officials to improve computer files and then submit proposals to Congress by mid-1983 on how to ensure that the problems would not crop up again. Although Treasury officials agreed to clean up their files, they never told Congress how they would prevent the problems from recurring.

The Treasury Department has improved its computer files since 1981 but serious problems remain.

Huge discrepancies

A Globe review of the files this summer, for example, turned up huge discrepancies in cash numbers for 1984 and early 1985. The review prompted the Treasury Department to launch a probe that discovered someone at its computer center in Detroit had been randomly adding zeros to some cash figures so the files overstated the dollar volume of transactions for those years. To correct the problem, officials had to reduce the dollar figures for those two periods by more than $59 billion.

The review also indicated that up to half of all the reports fed into the computer lack anything about the business or occupation of the person conducting the cash transaction – information that investigators need to pinpoint the uses of large blocks of cash. A confidential study of currency flows in California completed last month found that the business occupation space on almost one-third of 156,000 reports was left blank. Those reports covered $1.75 billion in cash transactions.

GAO's harshest criticism was that the Treasury Department failed to act quickly when it discovered flaws in the regulations adopted to make the system work. The department has still not corrected at least one of those flaws.

When the Treasury Department first issued regulations in the early 1970s, it did not say what a bank should do if it found that a customer was breaking large cash transactions into many smaller ones to avoid the reporting requirement, a technique called "smurfing."

The GAO told the Treasury Department to correct the problem, and on several occasions – including three between October 1975 and March 1977 – top Treasury officials promised they would order Stankey, the department's financial crimes and frauds adviser, to draw up the necessary revisions. But Stankey did not finish drafting the revisions until late 1979, the department didn't issue them until July 1980, and the newly issued regulations still did not solve the problem.

With rare exceptions, the government's reporting requirements can still be avoided – in a manuever that remains entirely legal – by breaking up cash transactions of over $10,000 into ones of under $10,000.

The GAO traced many of the Treasury Department's problems both with computers and regulations to a lack of staff. Treasury officials – especially former Assistant Treasury Secretary John M. Walker – have won national prominence recently by declaring all-out war on underworld finances. But until last year, Walker assigned only one person – Stankey – to administer the system. He recently gave Stankey two assistants. Stankey and one of the assistants expect to retire shortly.

Starting in the late 1970s, the GAO criticized law enforcement agencies for failing to investigate cash trends spotted by the Treasury's computer cash flow studies. Officials who have been briefed on the GAO's current study of the system say that GAO auditors have found some improvement but believe more needs to be done. In interviews with investigators and prosecutors across the nation this summer, the Globe found dozens who had never heard of the studies or used them.

As originally envisioned, several federal agencies – including Customs, DEA, the FBI, the IRS's Criminal Investigation Division, the Justice Department and the US Attorneys' offices – were supposed to pick up where Treasury computer analysts left off. They were to take the unusual cash flows spotted by the analysts and track them back to their source. If they found a criminal behind the currency, they were supposed to prosecute him and seize his assets.

Investigators and prosecutors are now taking their first steps toward doing just that. But their actions come 15 years after they noticed the need for going after both crime and cash.

Until recently, according to Richard Jarrett, DEA's intelligence chief in San Francisco, "Law enforcement was looking for the powder on the table. You know, that's what makes it sexy, gets the headlines."

One reason that most law enforcement officials failed to focus on criminal finances is that they were not trained to use the Treasury cash flow studies or work with financial figures. As one West Coast official explained, "You know most of my guys weren't numbers people to begin with. They signed on as agents, not accountants." Adds a local prosecutor: "I tell a DEA agent to check the Registry of Deeds on a drug dealer and he looks at me like I'm crazy."

However, until recently investigators could not have used the studies even if they had training or interest because they did not know the studies existed or, if they did, were not given easy access to them. A 1981 GAO survey of 27 law enforcement offices found officials at six were unaware of the studies or did not know how to obtain them. Officials at another 12 had almost never used them. Recent interviews suggest that much the same is true today.

Continued on next page

US often fails to uncover criminals' hidden wealth

Continued from preceding page

But there is another reason that officials have not made much use of currency flow information: they don't believe that regulators ensure it is accurate or that the analysts make sure it is complete. As Jarrett put it, "The people we want aren't filing, and nobody's making them."

This skepticism can translate into a less-than-energetic attack on criminals' assets. Even when investigators pierce a narcotics ring and arrest its leaders, they often neglect to identify and seize any but their most obvious possessions. The investigation into a 14-member drug ring led by Elmer Rodriguez and Donaldo Rengifo, both of Brookline, is a case in point.

After the ring was busted last December, investigators set about confiscating its profits. So far they have seized $300,000 worth of properties, mainly the homes and cars of the suspects. However, they overlooked several other assets that were somewhat harder to locate.

One member of the ring, Felix Rengifo of New York, was able to sell a taxi medallion for $75,000 a month after his arrest. Not realizing that Rengifo owned the medallion, investigators were unable to stop him from hiding the profits of the sale.

In another example, ringleader Rodriguez and Helmer Mosquera bought the three-story apartment building at 77 Highland st. in September 1983 for $6,500 – in cash. During the next 15 months, Rodriguez, one of the two alleged ringleaders of the operation, spent an estimated $100,000 in renovating the building. All the work – materials and the salaries of the dozen or so workmen on the job – was paid for with cash, according to sources familiar with the renovation project.

One workman said he received approximately $20,000 on the project; since he was paid in cash, he did not report the money to the IRS, and paid no taxes on it. "It was all gravy, heavy gravy for more than a year," he said. "Elmer would come every Friday to pay us and he'd have these bags of cash. I've never seen anything like it."

Rodriguez spent more cash, according to sources familiar with his business, renovating the Hyde Park house of a friend.

Although seizure law allows for the seizing of any property bought or renovated with drug money, neither property was taken by the government. Asked why, one prosecutor on the case said, "We just didn't talk to the same people you did."

A week after their arrest last December, Rodriguez and Mosquera signed their interest in the house over to their wives. Last May, the wives sold the apartment building for $75,000 to a Wellesley developer.

Shortly after buying the property, the developer received a visit from the DEA agent who led the investigation into the drug case. "He wanted to make sure that I bought the property legitimately, and I showed him that I had," said Arthur Jacobsen of Genesis Properties of Needham. When Jacobsen asked the agent why the government hadn't placed a lien on the property to advise prospective buyers of its past owners' criminal case, he said the agent told him:

"It's too long of a story to get into."

NEXT: *The international money trail*

This report was prepared by The Globe Spotlight Team, which consists of editor Stephen A. Kurkjian, reporter Daniel Golden, economics reporter Peter G. Gosselin, and researcher M.E. Malone.

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Spotlight

Money Laundering

Offshore banks lure dirty cash

Latin America relies on US drug dollars

Fifth in a series

EL PROGRESO, PERU – This dusty town on the Upper Huallaga river, so remote it does not appear on most maps of Peru, sees more American cash in a day than many Boston banks collect in a week.

Every few hours, small-engine planes touch down at the 25 clandestine airstrips within 10 miles of the town. They unload American bills and pick up cocaine paste made from coca leaves that grow on 80,000 acres in the river valley. Then they return to Colombia, where labs process the paste for smuggling to the United States.

The dollars – as much as $4 million on a busy day – have invigorated El Progreso's economy. Japanese cars navigate its unpaved, potholed streets, and concrete houses are replacing ramshackle wooden ones. Radios, electrical appliances and outboard motors are piled high at the outdoor market; they are bought and sold with thousands of dollars in cash. Two of Peru's largest banks plan to open branches in the town later this year.

Other bankers can't wait that long. Carrying footlockers stuffed with Peruvian currency, they fly into the airstrips in search of the dollars that the Colombians left behind. The coca growers, who need local currency for their daily expenses, sell the dollars cheaply.

In Lima, where American dollars are in great demand, the bankers make a killing selling the tainted cash.

"These banks are actually laundering money," Peruvian businessman Jorge Baptista Carrion said in an interview. "There are no questions asked. There is a law that says that banks can buy or sell any amount of dollars without having to check where they came from."

As in Peru, banks in several Latin American countries actively lure drug dollars. These porous financial systems channel the expenses of narcotics operations and hide the profits of dealers from both North and South America. Cash paid for the cocaine on Roxbury's Sonoma Street or marijuana smoked at Back Bay parties may wind up anywhere from Peru's black market to Bahamian bank accounts, from Colombia's stock exchange to the safes of jewelry wholesalers in Panama's Free Trade Zone.

Drug money has become an unofficial form of American foreign aid. Beset by inflation and foreign debt, some Latin American countries need dollars so desperately that they have turned into a launderer's paradise. They have rarely confiscated illicit cash. They have resisted pressure from Washington to monitor cash themselves or to sign treaties requiring them to turn over banking records.

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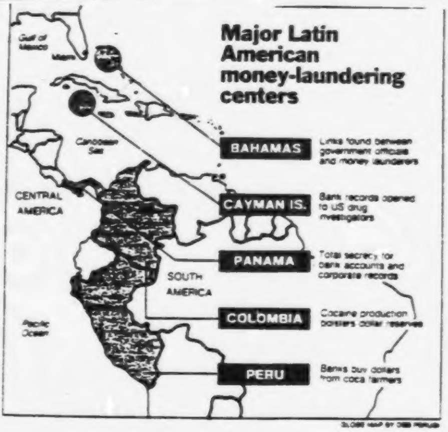


Major Latin American money-laundering centers

Gulf of Mexico
Miami
Caribbean Sea
CENTRAL AMERICA
SOUTH AMERICA
Pacific Ocean
BAHAMAS
Links found between government officials and money launderers
CAYMAN IS.
Bank records opened to US drug investigators
PANAMA
Total secrecy for bank accounts and corporate records
COLOMBIA
Cocaine production bolsters dollar reserves
PERU
Banks buy dollars from coca farmers

Latin America lures billions in US drug dollars

Spotlight ☐

Money Laundering

■ SPOTLIGHT
Continued from Page 1

Although US officials are unable to give an exact total, they estimate that at least $2 billion in American cash is washed each year through the Latin American countries most involved in money laundering. Billions more are wired to Latin American banks.

"Clearly billions of US dollars derived from illegal activities are being funneled offshore," concluded a Senate study released last month.

Despite years of negotiation, most of these countries have resisted pressure from Washington to monitor cash themselves or to sign treaties giving US drug investigators access to their banking records.

Officials of these countries argue that the United States should not expect them to disrupt their economies to stop the flow of drug dollars. If the United States wants to attack the drug problem, it should do so by educating its citizens against drug use.

Furthermore, they say, the loss of drug dollars can trigger unemployment and hardship, inviting Communist infiltration. In the Upper Huallaga valley, for instance, a coca leaf eradication program had to be suspended late last year because it prompted increased activity by antigovernment guerrillas.

In the absence of treaties, both North and South American drug dealers have taken advantage of open-ended currency exchange laws in Colombia and Peru to pay their expenses, such as the wages of growers and transporters. With their profits in hand, they turn to banks in Panama and the Bahamas, where strict financial secrecy laws safeguard drug money and records cannot be obtained by government subpoenas.

Drug traffickers tailor their laundering methods to the loopholes in local financial laws. In Peru, they pay growers directly in dollars. In Colombia, they convert an unlimited number of dollars to pesos at the "left hand window" of the national bank. They make huge dollar deposits in Panamanian banks. In the Cayman Islands, they move cash through lawyers or unregulated financial management firms.

Peru, the world's leading producer of coca leaves, is where approximately $800 million spent by American cocaine buyers ends up each year. These dollars are vital to a country that has 200 percent inflation and recently announced its intention to default on its foreign debt.

"Coca is our first export product," said a Central Bank official. "It's illegal, but it provides us with needed reserves. It helps the country's balance of payments. . .The problem with hot money is that those funds could leave in a second and the country would be without reserves."

When Peru liberalized its foreign exchange laws in 1977, one unstated reason was to draw cocaine dollars into the nation's banks. Peruvian banks now change unlimited amounts of foreign currency without asking questions, and they also issue dollar-denominated certificates of deposit.

One alleged drug trafficker, Raul Lopez Villar, changed $4.28 million into Peruvian currency at a bank in the Upper Huallaga valley. Convicted on narcotics charges, he was freed when the Peruvian Supreme Court ruled that "it was no crime to have foreign currency and not be able to justify it," according to former prosecutor Fernando Olivera.

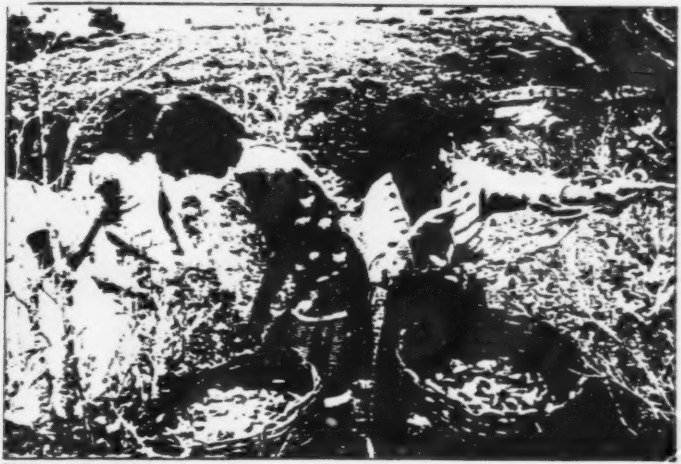
Manuel Ruiz Huidobro, special assistant to the president of Peru's Central Bank, said it cannot ask questions about dollar deposits for fear of sparking customers' withdrawals. "There would be a run on the bank," he said. "We have no intention of protecting coca, but our hands are tied."

The new president of Peru, Alan Garcia, is starting to crack down on the cocaine trade and its profits. He has fired 32 top-ranking police officers suspected of collusion with drug traffickers, and placed controls on foreign currency. But local observers say drug dollars still find their way into Peruvian banks.

Other Latin American countries depend as much on drug money as Peru. Justice Minister Enrique Parejo estimated in an interview that Colombia, once the world's leading marijuana producer and now the center for cocaine processing, earns $5 billion per year from the drug trade – $2 billion more than its income from all legal exports combined.

Even the United States, facing a trade deficit, has favored its need for foreign capital over law enforcement's concerns about the laundering of dirty money. Last year, the US Treasury Department allowed American companies to continue floating bearer bonds overseas on the rationale that the firms needed to be attractive to foreign investors. However, many law enforcement officials believe that drug traffickers launder cash by buying bearer bonds, because their ownership cannot be traced. Whoever possesses the bonds is their owner.

"There was a lot of dissension about that move," said one Treasury official. "We don't have a good data base, but all of us in government share the same suspicion that this is a problem."



Children pick coca leaves in Peru.

Globe Photo by Vera Lentz

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Colombia: Banks eager to buy dealers' cash

In Bogota, residents call it a "coronation." Checking black market prices in the financial pages of the morning paper, they notice about once or twice a month that the street value of the dollar has plunged overnight, until it is measurably below the rate offered at Colombia's banks.

They know immediately that a major cocaine sale has been consummated, and that Bogota is once again awash in American cash. Soon, there is a rush to the corner of Avenue Jimenez and Seventh Street, Bogota's black market Wall Street, to buy drug dollars while the supply is ample and the price is cheap.

Drug money has overwhelmed Colombia, which has supplied most of the cocaine and marijuana sold by major New England importers and distributors such as Timothy Minnig, Arnold Katz and Frank LePere. Traffickers own everything from soccer teams to cattle ranches, bribe everyone from bankers to judges.

Justice Minister Parejo said in his Bogota office that Colombia's democratic government is fighting for its life against the corrupting influence of drug barons.

"Drug traffickers have penetrated the highest levels of society. I don't think there's one institution in our country that hasn't been influenced by them," said a grim Parejo, whose predecessor, Lara Bonilla, was assassinated last year by drug traffickers. "Despite the fact that I'm on top of everything here, they could infiltrate this ministry. The danger for me is very great."

Yet Colombia faces another danger – economic collapse. Its dollar reserves dropped $1.4 billion last year, and it has been forced to limit import payments to $250 million a month.

The economic crisis tempts the government to accept dollars from any source – to the detriment of its own struggle against the drug trade. Last year, for example, Colombia's attorney general negotiated with three cocaine exporters in a secret meeting in a Panama City hotel. The exporters were asking for amnesty from prosecution. In return, they promised to boost Colombia's depleted foreign reserves by $3 billion. Embarrassed by unexpected publicity about the meeting, the government ultimately rejected the offer.

This spring, the government again balanced the appeal of drug dollars against the threat of the drug trade, when it considered granting an amnesty to foreign bank accounts held by Colombians. The economic virtue of the proposal was this: Colombians are prohibited from holding domestic accounts in any currency except the peso. Because foreign firms do not accept pesos, Colombian businessmen must pay for imported goods with dollars purchased from the government.

However, many businessmen have dollars in foreign accounts even though they are illegal under Colombian law. If there were an amnesty, the businessmen could pay for goods with those dollars, sparing the government from depleting its reserves.

The proposal's drawback was that it would open laundering routes for drug dealers moving dollars in and out of Colombia. It was finally rejected after Colombia's media opposed it. "The moral sacrifice is above the fiscal benefits," editorialized El Colombiano, a daily newspaper.

The amnesty debate was a microcosm of the tug-of-war with economic needs that has characterized Colombia's fight against drugs.

More than any other Latin American country, Colombia has cracked down on narcotics traffic. After Bonilla was killed last year, Colombia began complying with a 1979 extradition treaty with the United States. Since then, it has arrested and handed over seven drug dealers, and 14 more are in jail awaiting extradition.

It has also seized an estimated $3 million in drug money and proposed antilaundering laws now being considered by Colombia's Congress. The legislation would allow authorities to seize property used in narcotics operations and to appoint a tribunal to investigate politicians and businessmen suspected of receiving money or gifts from traffickers.

Yet for each successful step forward, there seems to be another step back. Bowing to popular dislike of the extradition treaty – many Colombians feel that those sent to the United States have received brutal treatment and unfairly harsh sentences – the government wants to renegotiate it to give Colombian courts power over extradition decisions. Since some Colombian judges are considered susceptible to bribes, this amendment would hinder extraditions.

Little enforcement

Also, law enforcement has been random and ineffective. The most important traffickers remain at large. Compared with drug profits, the amount of money confiscated is minute. The government has been unable to stop traffickers from smuggling dollars into Colombia. It has confiscated 500 planes used in narcotics operations, but most were cocaine-laden Colombian aircraft that crashed at take off. It lacks the manpower and radar to catch the planes that fly into hundreds of clandestine Colombian runways with cash from Miami or coca leaves from Peru.

Colombian customs officers rarely turn up drug dollars at Bogota's international airport, despite evidence that traffickers frequently move money through it. A blitz by US customs officers at Miami Airport in May found 13 passengers violating US law by carrying more than $10,000 abroad without reporting it. Eleven were flying to Bogota, and they had a total of $2.7 million in cash. The others were headed to Panama and Bolivia.

"Contraband and cash come into the airport," Parejo said. "Of course there is corruption."

The financial system reflects the hunger for drug money. Banks have what Parejo called "excessive" secrecy. A proposed treaty opening bank records to US investigators has fallen victim to anti-American emotions, kindled by the extraditions, and has not been ratified by the Colombian Congress.

The prohibition on dollar accounts forces Colombian cocaine suppliers to change American cash into pesos in order to make any investments in the country. But, instead of regulating these conversions of currency, the government facilitates them by permitting individuals to change an unlimited amount of dollars at the Banco de la Republica, Colombia's national bank. The practice is known as using the "left hand window" because the teller's booth on that side used to be the only one where foreign currency could be exchanged.

Last year more than $160 million was exchanged at the national bank. Half of them are believed to have been drug dollars, but no one is certain because the transactions are badly monitored. Customers must fill out a form, but it is marked "For Statistical Purposes Only," and tellers do not verify the information. Most drug traffickers reportedly say on the form that their dollars were received from tourists. When the marijuana trade boomed in the 1970s, according to local officials, "tourism" dollars brought to the left hand window increased tenfold.

Even members of Colombia's respected stock exchange indirectly launder the dollars sold through the

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left hand window. Instead of immediately receiving pesos for their drug dollars, the traffickers, like all left hand window customers, are given dollar certificates that cannot be converted into pesos for at least 90 days. Anxious for their money, the traffickers sell the certificates to Colombian financiers who in turn trade the notes on the country's stock market.

A harried national bank official explained in an interview why the country does not crack down on drug traffickers using the left hand window. "If we trace these people, we will only encourage them to go to the black market," which would deprive the banking system of dollar reserves, he said.

> **'Drug traffickers have penetrated the highest levels of society.'**
>
> Justice Minister Enrique Parejo

However, most traffickers already change their dollars on the black market because, unless there has been a sudden influx of drug dollars into the city, it offers a better rate. The market operates through travel agencies and money exchange firms with elegant offices and modern computers flashing the latest currency rates around the world.

The government allows the black market to flourish for a simple reason – it is vital to Colombia's economy. It relieves pressure on dollar reserves and props up the standard of living.

For example, many Colombians want to vacation in the United States. But the government only allots a maximum of $2,000 per year to each Colombian for tourism. So travelers buy as many extra dollars as they need on the black market, saving the government's reserves.

Similarly, only a few firms licensed by the government can legally purchase dollars from it and use them to import essential goods. So, businessmen who want to import luxuries seek out the black market and its drug dollars. Then they purchase their computer terminals or microwave ovens at the duty-free zone in Colon, Panama, and smuggle the contraband by boat into Colombia.

According to Panamanian government statistics, the Colon Free Zone exported $213.5 million worth of goods to Colombia in 1983. Another $134 million was listed as going to the island of Aruba off Colombia's coast, but its actual destination was most likely Colombia, sources said. Out of this total tab of $347.5 million, one Free Zone wholesaler estimated, between one-fourth and one-half was paid with cash from Colombia's drug-dependent black market.

Free Zone merchants said they were unconcerned about being paid in black market dollars derived from drug sales. "My father told me always, 'Never ask where the money comes from if you're in a legal business,'" said a jewelry dealer. "I don't care where my customers get their dollars or how they get them. The way to control drugs is not by stopping the money, it's through education."

Like bankers in the United States, those in Colombia are not immune to corruption. Banking authorities are investigating a recent incident in which Carlos Lehder, a major cocaine trafficker, narrowly escaped capture by police. In his hurry, Lehder abandoned $1.7 million in cash. The money, which was recovered, carried the seal of a Bogota bank.

Branch managers of Bogota banks said in interviews that drug traffickers had offered them everything from new cars to bags of emeralds in return for special services.

"Every day they offer you a bribe," one banker said. "It's amazing."

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Spotlight ☐

Money Laundering

Cocaine capital draws R.I. drug cash

Sixth in a series

MEDELLIN, COLOMBIA – The old aristocracy, the coffee planters and textile magnates, lived for generations in the terraced villas that make up the most exclusive neighborhood in this otherwise grimy industrial city. Today, cocaine dealers have moved into the spacious mansions, and the area's genteel look is marred by graffiti supporting their political causes: "Liberty to the extradited drug traffickers!"

Their new homes symbolize the political and economic influence that drug traffickers have bought throughout Colombia. In Medellin, a city of 1.2 million inhabitants that is known as the cocaine processing capital of the world, their power is particularly unbridled. Traffickers have a piece of nearly everything here, from hotels to soccer teams to giraffes in a nearby zoo. Even the churches have been restored with drug money.

Medellin's traffickers make their fortunes abroad. Most of their wealth comes from the United States: not only from recognized drug centers such as Miami, but also from a Rhode Island community only one square mile in size.

Investigators believe that more than $60 million per year flows 4,000 miles from Central Falls, R.I., to the violent, sprawling metropolis of Medellin (pronounced Med-a-een). This unlikely tale of two cities, a case study in international money laundering, shows how drug dealers circumvent US cash reporting laws, customs searches, and pursuit by the Colombian and American police.

The two cities originally came into contact because their economies both relied on textile mills. Fifteen years ago, a Central Falls textile mill owner who had relatives in Medellin began recruiting workers there. Today, Central Falls' 17,000 residents include 4,000 Colombians. Most are blue-collar workers, but some are drug traffickers who operate inconspicuously among the large Colombian population.

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MASS.
Central Falls
Providence
RHODE ISLAND
CONN.

GLOBE MAPS BY [illegible]

Hunt Street in Central Falls, R.I.

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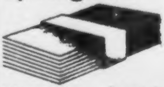
World cocaine capital thrives on R.I. drug cash

Spotlight ☐



Money Laundering

■ SPOTLIGHT

Continued from Page 1

According to Robert M. Stutman, regional head of the US Drug Enforcement Administration, dealers as far away as Toronto and Chicago buy cocaine from Central Falls traffickers. Once paid, the traffickers move much of their profit through Rhode Island financial institutions to relatives and associates in Medellin.

In the past year, at least 16 Colombian traffickers with links to Central Falls have been arrested, mainly in cases involving pounds of cocaine. According to local police, all of them also had Medellin connections.

"You see a lot of out-of-state cars in Central Falls and you wonder, 'What can they be coming here for besides drugs?' " said one staff member of a local drug prevention agency. "There's nothing else here to visit."

Among the most recent drug cases with Central Falls connections are:

● Erwin O. Monsalve, a Colombian national, was sentenced to seven years in prison last week for possessing cocaine with intent to distribute. According to testimony, authorities found a ledger detailing more than $10 million in cocaine sales between 1982 and 1984 during an April 30 raid on Monsalve's home in Malden, Mass. Monsalve is co-owner of the Sportsman Club, a Central Falls bar.

● Omar Vanegas, 31, of Central Falls was among five Colombian nationals arrested on Aug. 8 for allegedly running a million-dollar drug operation. Three of the other four defendants had ties to the city. Louis Gomez had moved from Central Falls to Pawtucket, and Camilio and Mario Montoya had relatives in Central Falls. Police seized five pounds of cocaine in a Pawtucket parking lot. Depending on demand, a pound of cocaine has a street value of between $70,000 and $170,000.

● Two Central Falls residents, Francisco Zuleta-Molina and Jose Calle Gonzalez, pleaded guilty in Maine on April 15 to charges of selling cocaine.

● Also on April 15, three Colombians pleaded guilty in a federal courtroom in Miami to charges of conspiracy stemming from a raid last November on a Hollywood, Fla., house. Agents confiscated more than 170 pounds of cocaine – worth tens of millions of dollars in street sales. Aymer Lopez, John Dioss and Edith Salinas had all recently lived in Central Falls.

● Last Dec. 7, federal agents and police stopped a 1981 Porsche on Interstate 95 in Warwick, R.I., and discovered 11 pounds of cocaine hidden inside. The car was being driven by Juan Carlos Santamaria, who told authorities that he had brought $100,000 in cash to Florida on Dec. 5 to buy the cocaine. Santamaria, who pleaded guilty to narcotics charges, had recently moved from a Central Falls tenement to a Warwick home. Police say that Santamaria paid $35,000 of the $85,000 price with bagfuls of cash.

● The Royal Canadian Mounted Police arrested Ovidio Herrera and seized 13 pounds of cocaine and nearly $250,000 in cash in his Toronto apartment. Herrera also had a Central Falls apartment and a $22,199 bank account in the Dexter Credit Union in town. Police say that Herrera is a Colombian national who was living in the United States as an illegal alien.

The influx of cocaine earnings has not improved the chronically depressed economy of Central Falls, a blue-collar city with 37 bars and the state's third lowest per capita income. The traffickers who run their operations out of Central Falls spend little of their cash there. At most, law enforcement sources said, the dealers buy a house and a fancy car or invest in a small business.

Despite their arrest record, federal agents have had only modest success in seizing the proceeds of Central Falls drug traffic. In the past 14 months, they have confiscated 14 cars, two houses and nearly $1 million in cash. In Santamaria's case, for example, they seized his Warwick house, the Porsche, a jeep, and a 1986 Buick Skylark that he had just purchased in cash.

Monsalve did forfeit $325,000 in cash that he kept in three safe deposit boxes in two Boston banks. Still, investigators say he earned millions more in profits, but they don't know where the money is.

"A lot of the money goes back to Colombia," says one prosecutor. "It's tough to live high off the hog in Central Falls without the police getting wind of it."

A lack of government record-keeping hampers investigators who need to trace cocaine dollars from Central Falls to Medellin. The only way to show how much cash moves through bank branches in Central Falls is to measure surplus currency that they send to the Federal Reserve Bank in Boston. But the Federal Reserve does not keep tabs on cash from individual banks, or from geographic areas smaller than New England.

US officials have designated three Central Falls police officers as federal marshals to give them authority to follow drug dollars beyond the city limits. Two of them, Rudolph Legenza and Michael White, said that in one ongoing investigation they have traced hundreds of thousands of drug dollars from banks in Connecticut and Central Falls to Miami and then Panama.

The cash had been exchanged for cashier's checks at the New England banks. The checks were mailed to a Miami account, from which funds were withdrawn and taken to Panama. Although Panama's bank secrecy laws prevented any further pursuit, the officers believe the money wound up in Colombia.

In another investigation, they said, a Central Falls trafficker was found to have invested in hotels and condominiums in Medellin. The trafficker, who has not yet been arrested, is considered a millionnaire in Medellin, White said. In addition, he owns large amounts of real estate in San Francisco, which authorities consider a new hot spot for money laundering.

Central Falls traffickers who want to move money to Colombia often start by converting their cash to checks at a local bank. Typically, they send their children to the bank to buy money orders to mail to Colombia.

The teen-agers usually carry thousands of dollars at a time, and visit the bank as often as four or five times a week. They never buy a money order for more than $10,000, because such a purchase must be reported to the Inter-

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nal Revenue Service.

"The teen-agers come in with $5,000 in cash," said one local banker, who asked not to be identified. "That's what makes it so conspicuous. How would a teen-ager get that kind of money?"

Traffickers who plan to carry cash to Colombia frequently exchange $20 bills for $100s, so their load will be less bulky. They exchange less than $10,000 at a time, to avoid the reporting law. According to police, one local bank trades so much currency that it often needs extra shipments of $100 bills. Customers seeking this service are asked to make an appointment, so the bank can order more money if needed.

In one probe, White and Legenza found a bundle of $47,000 in cash neatly wrapped in silver tape. Because it is illegal to carry more than $10,000 in cash out of the United States without reporting it, traffickers smuggle cash on international flights in such bundles taped to their bodies or hidden in the clothing of their children.

US customs officials lack authority to search outbound passengers for cash without probable cause. Customs agents at Colombia's commercial airports rarely confiscate cash; if there is any risk, traffickers can fly instead into dozens of private airstrips within easy reach of Medellin.

Medellin, like Central Falls, has a tottering economy. Its unemployment rate is 16 percent officially, nearer 30 percent in reality. Drug money from the United States is its life support system. Traffickers employ many people in processing labs downtown; the large number of labs is suggested by the daily accounts in the local newspapers of people burned in explosions of ether, an essential ingredient of cocaine processing.

Indirectly, the drug trade provides employment for chauffeurs and servants, fares for taxi drivers, guests for hotels, and jobs in a range of other businesses owned as fronts by the traffickers.

"Drug traffickers own all of the best businesses in Medellin," said one resident. Added a local journalist: "They have too much money, they are too well-armed, they have too many bodyguards."

Some traffickers have become heroes by spending drug money on the poor. Pablo Escobar, a fugitive authorities call one of the largest cocaine suppliers to the United States, built 1,000 one-room brick units for homeless people who had been sleeping at the city dump and scavenging its garbage for food. "Medellin Without Slums" also boasts a paved road, electricity, water and a school, courtesy of Escobar.

Like Medellin's exclusive neighborhood, the housing project is covered with graffiti protesting the government's policy of extraditing drug traffickers to the United States. A prominent sign makes sure that residents remember who to thank. It says, "Medellin Without Slums constructed in this sector 1,000 homes that will be given without any cost to the families that inhabit the municipal garbage dump. Pablo Escobar."

Escobar also established what has been called Latin America's finest zoo in a village halfway between Medellin and Bogota, the capital. Residents of both cities delight in driving to view the collection of hippopotamuses, giraffes and other imported animals. Admission is free. Escobar has been known to fly special guests into a nearby private airstrip for personal zoo tours.

Capitalizing on his reputation as a philanthropist, Escobar was once elected to the Colombian Congress. In the past year, since the government began its crackdown on drug traffickers, his popularity has protected him from arrest and extradition. According to one Colombian official, Escobar has evaded the police because he has been tipped off about their whereabouts in advance.

"Personally, I prefer Escobar to [Colombian President Belisario] Betancur," said one Medellin resident. "He's done a lot more for the people."

One law enforcement official said, "The popular image is that he's Robin Hood, and we're the sheriffs of Nottingham."

Unaided by a hostile populace, the Colombian police have only captured and extradited one Medellin criminal. Hernan Botero was convicted in June of laundering $55 million through Landmark Bank in Ft. Lauderdale and faces a possible 35-year prison term. He is to be sentenced Nov. 15. His brother Roberto received a seven-year sentence in the same case.

In Medellin, the Botero brothers are considered upstanding businessmen. They own the city's best-known hotel, the Nutibara, as well as one of Medellin's two professional soccer teams.

When they cannot rely on good will, traffickers turn to violence. They kill an average of 20 Colombian police officers per month. In recent years, one columnist and three reporters working for a Medellin newspaper have been murdered while investigating the drug trade. Because of the danger, US Embassy officers in Bogota are not allowed to visit Medellin.

Law-abiding Colombians who move to Central Falls carry the fear of drug traffickers with them. While police officers have encouraged them to come forward, and community leaders plan to establish a "Drop-a-Dime" hotline for anonymous tips, many Colombians remain reluctant to tip off authorities about drug traffic.

Said Legenza, "The word is, 'If you get caught informing, you're going to die.'"

NEXT: *The legal dilemma*

This report was prepared by The Globe Spotlight Team, which consists of editor Stephen A. Kurkjian, reporter Daniel Golden, economics reporter Peter G. Gosselin, and researcher M.E. Malone.

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EXTRADICION ¡ES ¡TRAICION!
VENEZUELA
Medellin
Bogota
COLOMBIA
ECUADOR
PERU
BRAZIL

Anti-extradition graffiti on wall of Pablo Escobar's housing project for the poor.

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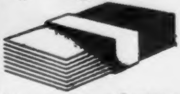

Money Laundering

Critics: Privacy violated by probes

Last in a series

Two years before Stephen D. Young was charged with running a major cocaine operation, Massachusetts State Police seized $160,000 in cash from him at Logan Airport – and then had to give it back.

To State Police, Young, of Nottingham, N.H., fit neatly into their profile of a drug dealer on the move: no baggage, a one-way ticket to Florida, previous convictions on narcotics charges and a flimsy explanation for the cash.

But their suspicions fell far short of legal proof that the money was earned from drug trafficking, and therefore could be forfeited to the government. In February 1983, the Suffolk County district attorney's office dropped its claim, and returned the cash to Young.

As the Young case suggests, the government has run into legal obstacles in its efforts to strike at drug trafficking by blocking its money trail. Since law enforcement has only recently begun attacking the proceeds of criminal activities, US courts and Congress are still debating which laws and investigative techniques used to stop money laundering are constitutional and which ones infringe on rights to privacy, counsel and due process.

"Their [prosecutors'] goals are right, their motives are right," said Richard A. Sharpstein, president of the Florida Criminal Defense Attorneys Association. "But let's not throw out the Constitution."

Financial institutions, whose records often constitute the only evidence of laundering, are caught in the middle of this legal tussle between investigator and suspect. Unlike Panama and other tax havens, the United States does not guarantee complete bank secrecy, but it does recognize an individual's right to confidentiality except when the government's interests take precedence.

The conflict has focused on the Bank Secrecy Act, which authorities consider their strongest weapon against money laundering. Passed in 1970, the act has been dogged by criticism from bankers and civil libertarians wary of governmental invasions of privacy.

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Cash probes can violate rights to privacy, due process

■ SPOTLIGHT

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In 1972, a group of California banks joined the American Civil Liberties Union in suing to stop implementation of the act, which, among other things, requires banks to report cash transactions of more than $10,000 to the Internal Revenue Service. They charged that it violated bank customers' privacy and gave the government too much power.

Two years later, the US Supreme Court upheld the law. In his majority opinion, Justice William Rehnquist wrote that the act was needed to stop "the heavy utilization of our domestic banking system by the minions of organized crime."

The court's three most liberal justices – William Douglas, William Brennan and Thurgood Marshall – dissented. Douglas wrote that the act was "devastating. . .I am not yet ready to agree that America is so possessed with evil that we must level all constitutional barriers to give our civil authorities the tools to catch criminals."

> 'Their [prosecutors'] goals are right, their motives are right. But let's not throw out the Constitution.'
>
> – Richard A. Sharpstein

Soon, the Watergate scandal would lead more Americans to share Douglas' fear of the destruction of constitutional safeguards. In 1976, Congress passed the Tax Reform Act, which severely restricted the kind of information that the IRS could release to anyone, including investigators with other agencies. Until its regulations were revised several years later to allow sharing of currency transaction reports, it largely reduced the usefulness of the cash reporting law.

Most banks now try to comply with the cash reporting law. But they are still reluctant to volunteer information about other transactions that may signify laundering – for example, the purchase of a series of cashier's checks for just under the reporting limit – because of a worry about potential lawsuits.

US law states that banks cannot divulge records without a government subpoena. As a result, if bankers tip off police about a suspicious transaction that later proves legitimate, they may be liable to a lawsuit by the customer. Yet, if they remain silent and the customer turns out to have been laundering money, they may be liable to criminal charges. At the very least, their public image will be jeopardized.

Bankers emphasized these worries at a recent state conference on money laundering. When Assistant US Attorney Patrick M. Walsh, who led the probe into Bank of Boston, urged bankers to report all unusual transactions to the government, one responded, "That could just open us up for a ton of lawsuits."

The American Banking Association has raised the same concern in its current fight against congressional proposals to make it a crime for banks to accept illicit funds. Banking Association officials have cited a recent Maryland case that shows the difficult bind in which bankers find themselves when they try to help investigators trace cash.

A branch manager at Suburban Trust Co. of Bethesda, Md., called police after a customer walked in with $800 in sequentially numbered $50 and $100 bills. Police arrested the man on suspicion of robbery. It turned out that he had just cashed his income tax refund check at the US Treasury Department in downtown Washington and been given crisp, new bills. He sued the bank for invading his privacy, and won. An appeals court judge who upheld the decision characterized the case as "The Bank That Talked Too Much."

Recent court decisions on another legal issue have also narrowed the latitude of investigators pursuing illicit cash. Federal courts in a number of cases have blocked a tactic that was becoming increasingly popular among prosecutors – seeking information about fees paid to defense attorneys in narcotics and racketeering cases.

In most of these cases, prosecutors sought to force defense attorneys to testify under oath about the source and amount of their fees. In several, prosecutors actually attempted to freeze the attorneys' fees so the money could be seized in the event of a conviction.

However, several courts have ruled that these tactics could interfere with the constitutional right to counsel by deterring attorneys from representing clients or by forcing them to reveal information protected by attorney-client privilege. As a result, the Justice Department recently told prosecutors to request clearance from Washington before subpoenaing attorneys or freezing fees.

Last year, the US Attorney in New Hampshire subpoenaed three Boston lawyers representing six clients under investigation for narcotics violations. The government was hoping to prove the existence of a conspiracy by showing that the alleged head of the drug ring had paid all of the legal fees in the case.

"It was frightening," said Nancy Gertner, one of the attorneys. "We faced contempt charges. We were all prepared not to testify." US District Court Judge Martin Loughlin later quashed the subpoenas, saying they would have an "arctic effect" on the defense bar.

Series at a glance

SUNDAY. THE PROBLEM: Turning their dirty cash into legitimate investments has been a relatively easy task for New England's major criminals.

MONDAY. THE DATA: San Francisco has become the nation's newest laundering center as federal vaults overflow with more than a billion dollars in surplus cash.

TUESDAY. THE BANKS: Why the US banking industry has failed to comply with the laws aimed at cracking down on money laundering.

WEDNESDAY. THE REGULATORS: The federal government's effort to crack down on money laundering has been hobbled by mistakes, contradictory policies and lack of manpower.

THURSDAY. THE LATIN AMERICAN LINKS: Banks in several Latin American countries actively lure drug cash to shore up declining dollar reserves.

FRIDAY. THE COLOMBIAN CONNECTION: Drug traffickers in a small New England city have been able to send cash to the world's cocaine capital by laundering it through local banks and financial institutions.

SUNDAY. THE LEGAL DILEMMA: The new war against money laundering can infringe on individual rights to due process, privacy and legal counsel.

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Court decisions have also stymied investigators seeking to stop smuggling of cash to foreign countries. Although the Bank Secrecy Act requires people to report whenever they take more than $10,000 in cash out of the country, federal courts were split until 1984 on whether customs officers could randomly search outbound travelers for large amounts of currency.

Last year's Comprehensive Crime Act required agents to have "reasonable cause" for such searches. But courts have yet to decide what constitutes reasonable cause. Without a guarantee of legal protection, many customs officers have taken the safe route and waved the passengers through.

Their hesitancy has permitted the movement of untold millions of dollars to Caribbean secrecy havens. A Senate report on offshore laundering released last month concluded that agents and inspectors have been reluctant to make searches. "...This reluctance is predicated, in part, upon a fear of incurring personal liability."

In addition, the reporting law does not define when a passenger can be said to be leaving the country. Customs officers who seize unreported cash when the plane is still on the ground can be sued by passengers claiming they intended to report the money before take-off. Once the plane takes off, of course, the passengers are beyond the reach of US Customs.

To strengthen their legal grounds for seizures, State Police at Logan Airport have developed a profile of travelers most likely to be carrying drug money. If the passenger fits the profile and the X-ray machine detects cash in his or her belongings, the money will be confiscated on suspicions that it comes from drug trafficking – even if the person is booked on a domestic flight and is, therefore, not violating the reporting law. Relieved of the cash, the passenger is allowed to continue traveling.

The typical passenger whose money is seized at Logan has these characteristics: He or she holds a one-way ticket purchased in cash on the day of the flight, arrives at the gate moments before the plane is scheduled to depart and has no check-in baggage. More likely than not, the destination is either Miami or Ft. Lauderdale, which are both centers for drug money and departure points for the secrecy havens of the Caribbean.

The cash also fits a profile: it is usually in $20 and $50 denominations and worn from use. Rubber bands are used to separate it into $5,000 piles, instead of the brown wrappers a bank would provide.

Since 1982, state troopers at Logan have seized more than $3 million in cash from 36 persons, including nearly a dozen men who have been identified as major drug dealers either in New England or in foreign countries.

Richard J. Cacciola of Northborough was about to fly to Ft. Lauderdale in July 1984 when the X-ray machine discovered $189,790 in cash in a gray vinyl bag. He told a state trooper that he was a commercial fisherman who had worked all his life to accumulate the money. When the trooper checked Cacciola's background and learned of two prior drug arrests – including one where $54,000 was confiscated – his cash was seized.

Jimmy Thompson, who has been accused by federal authorities of running a major heroin and cocaine distribution ring in Roxbury, was grabbed in 1982 with $20,985 in cash as he tried to board a plane to New York. Thompson is serving time on a drug conviction, as well as a perjury conviction stemming from his testimony about trafficking on Sonoma Street.

However, these seizures are temporary measures. For the money to be forfeited to the government, prosecutors must show at a Suffolk County Superior Court hearing that the cash "more likely than not" was earned from drug deals.

To avoid lengthy litigation, the Suffolk County District Attorney's office routinely negotiates a settlement with the owner of the money. For example, Cacciola recouped all but $30,000 of his money, and Thompson only forfeited $6,000.

Overall, the government returns more than half of the cash confiscated at Logan – leading many defense lawyers to suggest that the seizures were not only groundless but unconstitutional. Thompson's lawyer, Paul M. Buckley of Milton, said about the Logan seizures, "I think they're going too far over there, and if the right case came along the [Supreme Court] would rule the whole thing illegal."

This report was prepared by The Globe Spotlight Team, which consists of editor Stephen A. Kurkjian, reporter Daniel Golden, economics reporter Peter G. Gosselin, and researcher M.E. Malone.

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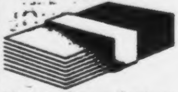
Nantucket land seized, Roxbury cash escapes

Spotlight ☐



Money Laundering

They came from opposite ends of South Carolina society. Jimmy Thompson was a high school dropout from the poorest neighborhood in Greenville. Attorney Thomas N. Rhoad 3d was the well-bred son of a state legislator.

Despite their different backgrounds, the two men were in the same line of work – drug trafficking – and they faced the same financial dilemma: how to launder the millions of dollars their separate drug operations generated.

Both were able to conceive schemes that, at least temporarily, hid the trail of their money. But in one case, the government was able to follow that trail and seize the properties that had been bought with the drug dollars. In the other case, investigators still don't know what happened to the profits.

Rhoad's drug ring laundered cash by stashing it in foreign bank accounts and using straw corporations to purchase expensive pieces of Nantucket real estate. Still, the government ended up with $4 million in cash and property.

Thompson's, on the other hand, made as much as $10 million between 1981 and April 1983 selling heroin and cocaine in the Sonoma Street area of Roxbury. But investigators can only speculate that the cash was carried to a New York City partner.

"There's a lot of money unaccounted for," said Anthony Duarte, an agent for US Drug Enforcement Administration. "It has to be somewhere, we just haven't been able to find it."

Today, all of Rhoad's assets belong to the government, and Thompson's do not, because of the different approaches that law enforcement agents took in investigating the cases.

Thompson's pursuers in Boston and Greenville gave priority to choking the drug flow, not seizing the profits. They used traditional methods such as wiretaps and surveillance to try to break his organization's hold on the East Coast cocaine and heroin trade.

But because South Carolina investigators tracked Rhoad's footprints through public documents and financial records in the United States and abroad, they succeeded not only in dismantling his drug ring but in capturing its profits. In fact, they began to seize Rhoad's property even before they brought criminal charges against him and his associates.

"It was an unusual way to approach a case," said E. Bart Daniel, an assistant US attorney in Charleston, who prosecuted Rhoad. "We managed to take away their cash and their property, which is more effective than simply putting them in jail."

Investigators on the Thompson case had an urgent reason for concentrating on the drugs first. Thompson and two partners, who became known as the "Capsule Boys," were flooding inner-city neighborhoods in New York, Boston, Bridgeport, Conn., Roanoke, Va., and Greenville with thousands of capsules of cocaine and heroin.

Yet Greenville remains a center for cocaine and heroin distribution, despite the arrest of Thompson and his two associates earlier this year. Until they locate and seize the millions of dollars in profits earned by the operation, investigators now concede, they will not be able to push the drug trade out of Greenville.

Investigators did make a little headway in tracing the proceeds of Thompson's Boston network. According to a federal indictment against seven alleged members of his Roxbury operation, hundreds of thousands of dollars in cash were carried to New York City. One investigator, who asked not to be identified, said much of the money was handed over to Thomas A. (Blue) Burnside, who was managing the group's Connecticut and Harlem rings at the time. Burnside, who told arresting officers he was a "financial consultant," was sentenced this spring to 54 years in prison on narcotics charges by a federal judge in South Carolina.

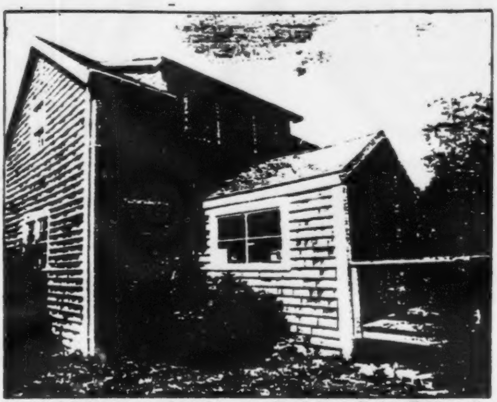
His lawyer, Daniel Greenberg of New York, denied in a telephone interview that Burnside was part of the drug ring or received any money from Thompson's Boston couriers. Greenberg said that Burnside was gainfully employed in New York as a manager of several fast food restaurants, which were owned by Noah Robinson, a Chicago entrepreneur and the half-brother of Rev. Jesse Jackson.

Investigators trying to determine where Thompson's group may have hidden its drug profits said they want to learn more about the relationship between Robinson and Burnside, but do not have sufficient cause to subpoena records.

Robinson, a Greenville native, said in a recent telephone interview that Burnside had worked for him as a security guard on several occasions in 1981 and 1982, but did not manage his restaurants. He said he had hired Burnside because their families had been friendly in Greenville. Robinson said that he did not know Burnside was involved in drug trafficking, and that Burnside had never invested any money with him.

"We never had any business relationship, except he worked for me as a security guard for a short period of time," Robinson said. "Those restaurants were bad investments anyway. I wish someone had been willing to put some extra money into their accounts. Maybe that's what I needed to get them to stay open."

Records in Greenville show Burnside's sister opened a disco in a building owned by Robinson. The first floor of the building was rented to a delica-



Nantucket house purchased by convicted drug dealer Thomas N. Rhoad.

Globe Staff Photo by Stan Grossfeld

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tessen managed by the wife of Roosevelt Butler Jr., Burnside's drug partner who was sentenced in the same case to 47 years in prison.

Beyond the two small businesses, investigators have found little evidence of Thompson, Burnside or Butler spending heroin cash in Greenville. Unlike most drug traffickers, the men did not own luxury cars, private planes or expensive homes.

By contrast, investigators first looked at Rhoad and his associates because of their lavish spending. Early in 1982, drug enforcement agents heard rumors that unnamed drug distributors were buying up a condominium development in the resort town of Hilton Head, S.C., a few miles from Rhoad's hometown of Charleston.

Soon, they found that one of the condos was bought by a corporation in England's Channel Islands, off the coast of France. It turned out to be one of several corporations formed there by Rhoad and his partner, Barry J. Foy.

The Channel Islands offer bank secrecy and low taxes, making them a convenient link in a money laundering chain for drug traffickers such as Rhoad and Foy who wanted to buy real estate in the United States without directly paying cash. David John Capps, the English solicitor who formed their corporations, later testified that he had accepted hundreds of thousands of dollars in cash from the two men.

In the spring of 1980, Rhoad took a trip with his girlfriend to Nantucket where he had vacationed as a boy. He would eventually buy three properties there for a total of more than $400,000 and in each instance, would have the cash wired from his Channel Islands accounts to a Nantucket bank.

But because Rhoad had to purchase the properties through his foreign corporations – Bacchus Properties Ltd. and Atlantic Moors Properties Ltd. – he was fearful that Nantucket residents might become suspicious of him. When he bought his first house there, he instructed Ann Killen, the real estate agent who handled the transaction, to tell any inquirers that he was just a caretaker.

One agent at Killen's firm said Rhoad did not seem out of the ordinary: "He was quiet, kept a low profile. To us, it was just a normal transaction between banks and lawyers."

Once, one of Rhoad's drug distributors flew to visit him on Nantucket, carrying at least $100,000 in cash. According to the testimony of Rhoad's girlfriend, Maura Mooney, she and Rhoad hid the cash away in safety deposit box #101 at Nantucket Savings Bank. The money had been spent before investigators were able to freeze Rhoad's assets.

Since money in safety deposit boxes is not subject to federal reporting requirements, criminals frequently use them to hold cash or other valuables. When Rhoad was arrested, investigators learned he had an additional $395,000 hidden away in four bank deposit boxes in New York and California.

According to prosecutor Daniel, Rhoad was aware by early 1983 that federal investigators were on his trail. When he was sure the agents had learned the names of his Channel Islands corporations, he created a corporation in Panama and opened a Bahamian bank account for it. Money was wired from the Channel Islands to the Bahamas.

When investigators found out about the Bahamian bank account, Rhoad hopped on a plane with two empty suitcases and withdrew, in cash, almost $1 million from the account. Then he did something risky.

"He walked about two blocks down the street into another bank and deposited the money there. He set up a signature account and didn't even take a deposit slip," Daniel said.

The advantage of a signature account to Rhoad was that he would not receive a passbook, account number or receipt. So federal investigators could not discover the account's existence, let alone confiscate the money in it, without help from Rhoad himself. The disadvantage was that, without a receipt for his deposit, he could have been cheated by the bank.

Several months later, in July of 1983, Rhoad was indicted and fled South Carolina. Police found him in San Diego last March, living under the alias Cullen Lee Brown Jr. Foy was arrested in the same month at a New York airport.

Before the two arrests, police had initiated forfeiture proceedings against Rhoad's three Nantucket parcels, a downtown Charleston warehouse, and a Lincoln Continental that he gave to his father. They had seized Foy's $450,000 restaurant in Charleston's historic district, two boats, two Jeeps and almost $100,000 in cash. While in custody, the two men turned over an additional $1.4 million in cash and property.

Now serving a 15-year sentence, Rhoad recently declined a Boston Globe request to be interviewed. An article on money laundering, he said, "may give a false impression to would-be law abiding citizens that this is a viable method of circumventing our tax and currency laws."

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BANK SECRECY ACT ENFORCEMENT AND RELATED ACTIVITIES
OF THE
FEDERAL HOME LOAN BANK BOARD

A REPORT TO THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U. S. HOUSE OF REPRESENTATIVES
APRIL 17, 1986

THE BANK SECRECY ACT

QUESTION 1

Indicate the number of institutions examined by your agency since January 1, 1985, and the number and type of violations of the BSA found at these institutions, and actions taken by your agency on these violations.

ANSWER

The reports that we file semiannually with the Department of the Treasury contain this data for the period from January 1, 1985, through December 31, 1985. Specifically:

Number of institutions examined	1,808
Number of institutions in violation	10
Number and type of violations	
Failure to file currency transaction reports	40
Failure to maintain a list of exempt customers	6
Total Violations	46

Our 1985 semiannual reports, dated August 27, 1985 and April 8, 1986, are attached as Exhibit 1 and Exhibit 2, respectively. The attached reports describe the supervisory actions taken in each of the 10 institutions at which violations were found.

In our August 27, 1985, report to the Treasury Department, we stated that with regard to one institution (The first institution listed on the "summary sheet"), the Office of Examinations and Supervision (OES) was in the process of developing additional information in order to determine the exact nature of 32 reported "cash deposit" transactions for which currency transaction report forms were not completed or filed. OES has since determined, in a special examination of the institution, that the transactions were transfers and/or rollovers from existing certificate accounts to new certificate accounts. The transactions did not involve cash, and thus the filing of the currency transaction reports was not necessary.

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QUESTION 2

Describe the training programs given to your examiners in BSA techniques and procedures. What improvements, if any, have been made since January 1, 1985?

ANSWER

The Bank Secrecy Act is a part of the curriculum of the New Examiners Training School (NETS) which all new examiners must attend. A copy of the Instructor's Outline for the part of NETS which deals with the Bank Secrecy Act is attached as Exhibit 3. A copy of the Interim Report to the President and the Attorney General entitled, "The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering," (Exhibit 4) is given to all examiners attending the session.

The Bank Secrecy Act portion of NETS utilizes a specially prepared video tape presentation on the Bank Secrecy Act. See Exhibit 5 for a copy of a memorandum which describes the content of the video tape presentation. As the memorandum indicates, we intend to use the video tape presentation as refresher training for all staff members involved in examination or supervision functions relating to the Bank Secrecy Act.

QUESTION 3

Describe efforts your agency has undertaken to improve communications with law enforcement agencies. What legal or policy impediments still exist that interfere with an open communication between the agency and law enforcement officials. Are they justified, in your opinion?

ANSWER

This agency's major effort to improve communications with law enforcement agencies has been the revision of a criminal referral form (Form 366, Exhibit 6) and the procedures for filing that form, which was designed in cooperation with the Department of Justice and the Federal banking agencies. Form 366 is used to report criminal activity, including but not limited to Bank Secrecy Act violations. The revised form, which is lengthier than the previous version, was developed in response to specific recommendations from the Justice Department with regard to the information that Department needs for initiating and pursuing criminal investigations. (See Exhibit 7, this agency's memorandum announcing the use of the revised form, and Exhibit 8, the Department of Justice's press release on the signing of the interagency agreement designed to improve the detection, investigation, and prosecution of fraud in insured institutions.) In addition, a short version of the form was developed in order to facilitate reporting of less serious offenses (such as teller defalcations) involving less than $10,000 and not involving directors, officers or other affiliated persons.

Not only is the new form used by our examiners, attorneys, and other Board representatives, but for the first time all FSLIC-insured institutions are required to file criminal referrals. One anticipated effect of mandating the use of Form 366 by regulated institutions should be to ease the workload of examiners, since examiners now prepare Form 366 only in cases in which the institution fails to file a referral or makes an inadequate referral. The institutions' forms are provided to the Directors of Examinations.

In accordance with the requirements of the Right to Financial Privacy Act, Bank Board referrals using the revised form do not identify the names or provide back up account documents for those customers who are protected by that act. Under the revised procedures, the Department of Justice uses Grand Jury subpoenas (which are exempt from the Right to Financial Privacy Act) to obtain complete records about the conduct described in the referral. In our response to your questions with regard to the Right to Financial Privacy Act (Title XI of the Safe Banking Act) we have discussed continuing impediments to open communication between this agency and law enforcement officials and the cumbersome nature of this process.

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QUESTION 4

Describe the progress, if any, that has been made between your agency and the Federal Reserve regarding the type of currency shipment reports that are made available by the Fed. Has your agency made use of such reports? Be specific.

ANSWER

Until recently, savings and loan institutions were not permitted to use the currency services of the Federal Reserve Banks. Therefore, there were no reports available from the Federal Reserve Banks that would assist us in examining for compliance with the Bank Secrecy Act. Because some savings and loans are now beginning to use the currency services of the Federal Reserve Banks, we have incorporated in our proposed revised examiner instructions regarding the Bank Secrecy Act a provision that will cover the review of reports from Federal Reserve Banks. The instructions will be similar to those used for other regulatory agencies. (See Exhibit 9; specific reference to the Federal Reserve Banks' reports are made in Module 1, item 7 and Module 2, items I B and II A6.)

QUESTION 5

Describe the management controls over implementation of BSA responsibilities that were in place before January 1985, and changes, if any, since that time.

ANSWER

Management Procedures in Place as of January 1, 1985

Examiners, who were employees of the twelve district offices of the Office of Examinations and Supervision, were responsible for determining whether insured institutions were in compliance with the provisions of the Bank Secrecy Act and its implementing regulations. Supervisory Agents, employees of the twelve Federal Home Loan Banks, were responsible for initiating corrective action when a) examiners reported that the Bank Secrecy Act policies, practices, or procedures of an insured institution were deficient, or b) examiners reported possible violations of the Bank Secrecy Act or its implementing regulations. The Office of Examinations and Supervision in Washington was responsible for direct oversight of examination and supervision with regard to the Bank Secrecy Act and also for establishing examination and supervisory procedures and requirements.

Management Procedures in Place as of July 6, 1985

Effective July 6, 1985, the Board transferred 860 staff members (747 examiners and 113 clerical and support staff) from the twelve district offices to the twelve Federal Home Loan Banks and also transferred responsibility for conducting examinations to the Federal Home Loan Banks. After those changes, examiners continued being responsible for determining whether insured institutions were in compliance with the provisions of the Bank Secrecy Act and its implementing regulations. Supervisory Agents continued being responsible for initiating corrective action when needed. In addition, the Bank Presidents, who are also the Board's Principal Supervisory Agents, became responsible for oversight of the examination process. The Board's Washington Office of Examinations and Supervision (OES) continued to be responsible for establishing examination and supervisory procedures and requirements relative to the Bank Secrecy Act, and OES became responsible for the overall monitoring and post-auditing of examination and supervision at the Federal Home Loan Banks.

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QUESTION 6

Describe the initiatives your agency has taken to broaden the knowledge of and exposure to reporting requirements of the BSA for those institutions you regulate.

ANSWER

1. The Board has provided the institutions it regulates with full information concerning Bank Secrecy Act regulations, regulatory amendments, and other directives and information pertaining to the Bank Secrecy Act. Since January 1, 1985, the Board has sent the following memoranda to all regulated institutions:

   - o **Bulletin # PA-7a-3** (Exhibit 10) - Describes the responsibility of independent public accountants under the Bank Secrecy Act.

   - o **Memorandum # T 53-7** (See attachment to Exhibit 10) - Reminds Board staff of accountability for securing insured institutions' compliance with the Bank Secrecy Act and reminds management officials in those institutions of their responsibilities under the Act; reiterates the basic purposes and requirements of the Act.

   - o **Memorandum # AB 69** (Exhibit 11) - Distributes an Internal Revenue Service news release announcing IRS's assumption of responsibility for reviewing exemption lists and approving or denying individual requests for exemptions from the currency transaction reporting requirements of the Bank Secrecy Act; informs institutions where to direct questions concerning exemptions.

   - o **Memorandum # T 53b** (Exhibit 12) - Distributes the amended Bank Secrecy Act regulations in their entirety; consolidates several earlier T memoranda that had distributed individual amendments to the regulations; summarizes key provisions of the amended regulations.

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2. The Board has made clear to the institutions it regulates that it expects them to provide full information to their employees concerning their responsibilities under the Bank Secrecy Act.

   - o In May 1985, memorandum T 53-7 (Cited earlier as attachment to Exhibit 10) was sent to all insured institutions and, *inter alia*, directs the management of each institution to establish employee training programs and to establish operating procedures and compliance guidelines that are available to all employees who come into contact with currency transactions.

   - o In addition, our Bank Secrecy Act examination procedures (Exhibit 13) state:

     > The examiner should ascertain whether the institution has established a program of employee education with regard to the requirements of the regulations.
     >
     > a. Tellers, through an ongoing training program, should be apprised of the reporting requirements for large cash transactions.
     >
     > b. Operations personnel should be made aware of the current requirements of the regulations and management should periodically reinforce the importance of compliance.
     >
     > c. Operations personnel (i.e., tellers, branch managers) should be interviewed to ascertain whether they are sufficiently knowledgeable concerning the regulations and operating procedures to assure compliance. This phase of the examination should be conducted at those branches which conduct relatively large volumes of cash business.

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QUESTION 7

Describe the role your agency played in the Attorney General's Bank Fraud Working Group. Cite specific examples of how your agency has implemented that agreement.

ANSWER

The Bank Board has been an active participant in the Working Group with the Director of its Office of Enforcement and a senior Enforcement attorney attending the regular meetings of the group. Following the execution of the Agreement last April by the Attorney General, the Director of the FBI, and the heads of the Bank Board, the Comptroller of the Currency, the FDIC, and the Federal Reserve Board, the group has continued to meet on a monthly basis to assure implementation of its agreement, to promote further cooperation among the civil and criminal law enforcement authorities, and to continue our pursuit of certain desired legislative amendments.

In particular, the Bank Board now has in operation the new criminal referral form, which was developed jointly by the Working Group members. By regulation which was proposed for comment in July 1985 and finalized in December 1985, the institutions regulated by the Bank Board are required to complete and file their own criminal referrals on this form. (See response to Question 3 above.) This requirement has been implemented successfully and institutions around the country are complying with its requirements. In calendar year 1985, the Board's examiners filed 150 Forms 366 and insured institutions filed 652 forms. In the first three months of 1986 examiners filed 27 forms and institutions filed 911. By requiring institutions to make referrals the Bank Board has assured that its own examiners are making criminal referrals only where an institution refuses to do so or where an institution's referral is inadequate (such as where senior management is involved in the suspected offense).

As a result of the Working Group, the Bank Board and other participants have established local points of contact throughout the country so that the supervisory agency and Justice Department representatives can communicate quickly and directly whenever law enforcement concerns arise. We also have improved our communications with all layers of Justice Department officials and are participating in Justice's recently implemented tracking system for agency criminal referrals. In addition, all agencies are cooperating in providing specialized training concerning the investigation of bank fraud that was previously available only to FBI agents.

Most importantly, the Bank Board is pleased that more Federal criminal prosecutions appear to be occurring around the country in response to criminal referrals made by the Bank Board and the institutions it regulates.

QUESTION 8

Submit copies of all revised regulations, banking circulars, newsletters, internal communications, updates to manual for examiners, and any other written information pertaining to enforcement efforts of the BSA undertaken by your agency since January 1, 1985.

ANSWER

In addition to the issuances submitted in conjunction with Questions 2 and 6, the following memoranda issued since January 1, 1985, and pertaining to the Bank Secrecy Act are attached:

- **Memorandum # AB 59** (Exhibit 14) - advises staff of a memorandum sent by the Department of the Treasury to all insured banks and savings and loan associations.

- **Memorandum # AB 62** (Exhibit 15) - reminds examiners of their responsibilities to personally complete FHLBB Form 919; to use expanded scope examination procedures under the circumstances listed in the Bank Secrecy Act examination program; directs examiners to prepare interim examination reports in order to expedite the reporting to supervision of material or suspicious Bank Secrecy Act violations.

- **Memorandum # AB 63** (Exhibit 16) - relates to coordination with the Department of the Treasury with regard to Internal Revenue Service Bank Secrecy Act investigations.

- **Memorandum from OES Director** (Exhibit 17) - advises the Board's Principal Supervisory Agents of the Board's efforts to improve its activities with regard to the Bank Secrecy Act.

Several other issuances may also be of interest since they apply to examination and supervision with regard to the Bank Secrecy Act. (Note, however, that their application is not limited to the Act alone.) Attached are:

- **Memorandum from Acting OES Director** (Exhibit 18) - reminds Directors of Examinations that all examiners carry a responsibility to determine compliance with laws and regulations.

- **Memorandum from Chairman Gray, August 9, 1985** (Exhibit 19) - directs Supervisory Staff to take enforcement action for material violations of regulations.

- **Memorandum from Chairman Gray, August 23, 1985** (Exhibit 20)- directs vigorous use of all enforcement tools and establishes new reporting procedures for material violations of laws, regulations, and agreements.
- **Memorandum from Chairman Gray, February 12, 1986,** and attachments (Exhibit 21) - streamlines the procedures for interim reports of violations and other significant problems detected during examinations.

In addition, this agency is currently in the process of developing a number of other issuances related to the Bank Secrecy Act. These include:

- A revision of our Bank Secrecy Act examination procedures, as mentioned in response to Question 4, above. The revision is being made
  - a. As part of a revision of our entire Examination Objectives and Procedures Manual to bring the manual up-to-date and improve its utility for examiners.
  - b. To encompass all the requirements of the interagency procedures, which have recently been amended (see Exhibit 9; specific references to the Federal Reserve Banks' reports are made in Module 1, item 7 and Module 2, items I B and II A6.)
  - c. To reflect recommendations from the Department of the Treasury and the Internal Revenue Service concerning the content of examination procedures (these recommendations are in Exhibits 22 and 23.)
- Supervisory procedures for the Supervisory Agents in the Federal Home Loan Banks; these procedures will be part of a new Supervisory Objectives and Procedures Manual that is currently in the process of development.
- A memorandum to all professional staff advising that the Department of the Treasury has redefined "willful" in a footnote on page two of its memorandum attached to our **Memorandum # SP 31** (Exhibit 24) to read:

> The term willful in a civil penalty context means action taken knowingly, consciously, intentionally or with reckless disregard. There need not be a knowing violation or specific intent to violate the law in order to sustain a civil penalty.

- A memorandum transmitting responses prepared by the Department of the Treasury in response to questions posed by financial institutions relating to Treasury's Bank Secrecy Act regulations.
- A memorandum listing the Internal Revenue Service Guidelines for Requesting Special Exemptions from the Financial Reporting Requirements of Volume 31 Code of Federal Regulations Part 103.

- A memorandum distributing the recently revised Currency Transaction Report (Form 4789).

- A memorandum distributing tc Federal Home Loans Banks guidelines for reviewing Currency Transactions Reports filed by financial institutions developed jointly by the Office of Enforcement and Operations at the Department of the Treasury, and the Office of Investigations at the Internal Revenue Service (Exhibits 22 and 23).

- A reissuance of Bulletin #PA-7a-3 with specific guidance on audit work relative to the detection and reporting of money laundering activities; as discussed in Memorandum # AB 66 (Exhibit 25), the language of Bulletin # PA-7a-3 as it was originally issued (See Exhibit 10) was too broad to effectively provide adequate guidance to independent public accountants.

Title I (Supervisory Authority Over Depository Institutions)

In 1978 Congress gave banking regulators authority to impose civil money penalties for violations of laws, rules and orders. The new authority gave the agencies the flexibility they needed to impose penalties on individuals or institutions for violations which did not rise to a criminal violation.

QUESTION A

Specifically, is there any merit to considering giving the regulators authority to impose civil money penalties upon financial institutions for their failure to report under BSA, or should the Treasury continue to have the authority to impose such penalties?

ANSWER

The Bank Board presently has the authority to assess civil money penalties only for violations of final cease-and-desist orders (and willful violations of the Change in Savings and Loan Control Act and violations of the Savings and Loan Holding Company Act.) The assessment process is a lengthy one requiring a full Administrative Procedure Act hearing if the institution or individual does not consent to the payment of a proposed penalty. Where other authorities -- Treasury, Justice, IRS -- already have primary responsibility for imposing penalties under the Bank Secrecy Act, it does not appear necessary or desirable to duplicate this effort and authority within the financial institutions regulatory agencies.

QUESTION B

To what extent could these powers be improved upon to lend support in appropriate cases to criminal law enforcement investigations?

ANSWER

Title I of FIRICA, in addition to granting limited authority to assess monetary penalties against insured institutions and their officials, enhanced the agencies' cease-and-desist and removal-prohibition authority in certain areas. Because there are civil and administrative powers, it is not known how these actions could assist criminal investigations, but the answer to the following question makes suggestions that could assist in the overall effort to deal with the criminal element in our nation's financial institutions.

QUESTION C

To what extent, if any, might the supervisory powers over depository institutions under existing law be extended to uncover criminal activities such as tax evasion, drug trafficking or money laundering, which could affect the safety and soundness of a financial institution?

ANSWER

Existing statutory authority to remove management officials is extremely exacting. In addition to proving a violation of law, rule or regulation or an unsafe or unsound practice, the agency must demonstrate, among other strict requirements, that the violation or unsound practice resulted in substantial financial loss to the institution or personal gain to the individual. Money laundering may be undertaken without loss of any kind to the financial institution involved and cooperative bank officials rarely have been found to have profited personally from their involvement. If violations of BSA were added to the grounds for the institution of removal proceedings against institution officials and employees, it is believed that a significant deterrent effect would result. 1/

While the agencies have broad power to examine and investigate for civil purposes, it is the Justice Department and IRS that have criminal investigative authority in the identified areas. It is recommended that any impediments to their conduct of such investigations be removed. We fully support the proposed amendments to the Right to Financial Privacy Act recommended by the Department of Justice to deal with one if these impediments, as discussed in more detail below.

1/ There is precedent for doing this. In 1982, all of the agencies' removal authority was amended to add violations of the Management Interlocks Act to the grounds for initiation of a removal action. This was done without linking such violations to the additional requirements of (1) substantial financial loss to the institution or personal gain to the individual and (2) personal dishonesty or a continuing or willful disregard for safety and soundness, which must accompany other violations of law before removal actions may be initiated.

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TITLES VI and VII (Change in Bank Control Act and Change in Savings and Loan Control Act)

The Safe Banking Act of 1978 corrected, to a great extent, one of the most glaring gaps in the regulatory structure of our depository institutions, i.e., the lack of control over transfers of ownership of banks and savings and loans between individuals or groups of individuals However, in light of certain ongoing criminal activities, the Change in Bank Control Act may need to be amended.

QUESTIONS

A. What modifications, if any, do you feel are necessary to deny acquisitions of control to unqualified or dishonest individuals?

B. Should more specific standards regarding what constitutes sufficient integrity or criteria used to determine what would not be in the best interest of the depositors or the public, be included by statute or imposed by regulation?

C. Should the agency be given more time in which to disapprove an application for change of control (currently within 60 days, not to exceed 90 under certain circumstances)?

D. What is the standard used for the term "willful" under the Act? Does this definition create problems for the agency? If so, what are they?

E. What-problems, if any, is the agency incurring in obtaining sufficient relevant information of foreign nationals seeking to acquire U.S. depository institutions?

ANSWER

Acquisitions of "control" of insured institutions are governed either by the Change in Savings and Loan Control Act (Control Act) or by the Savings and Loan Holding Company Act (Holding Company Act). The Holding Company Act prohibits any "company," directly or indirectly or acting in concert with one or more other persons, through one or more subsidiaries, or one or more transactions, from acquiring control of an insured institution without the prior written approval of the Bank Board. The Control Act applies to acquisitions of control that are not subject to the Holding Company Act. It prohibits any "person," acting directly or indirectly or through or in concert with one or more persons, from acquiring control of an insured institution through a purchase, assignment, transfer, pledge or other disposition of voting stock of an insured institution unless the Bank Board has been given sixty days' prior notice pursuant to a complete Control Act Notice, and within that time period has not objected to the acquisition or extended up to another thirty days the period for objection.

Due primarily to the volume and complexity of the information submitted in Control act notices by prospective acquirors, it has been the Bank Board's experience that most, if not all, of the sixty-day statutory period is required for the Board to complete its careful review and analysis of the notices. In many cases, the Board must extend the time period for up to an additional thirty days, as permitted under the Control Act. In order to provide the Bank Board with sufficient time to review and process Control Act notices, the Board encourages the Subcommittee to consider an amendment to the Control Act to extend from sixty to ninety days the period for objection to an acquisition but to retain the current thirty-day provision for extension of the period for objection. The proposed amendment would be consistent with the Holding Company Act, which requires the Bank Board to render its decision on an acquisition within ninety days after submission of a complete application.

Both statutes employ expansive definitions of control. In the Control Act, the term connotes the power, directly or indirectly, to direct the management or policies of an insured institution. The Holding Company Act provides that the term includes control in any manner of the election of the majority of the directors of an insured institution. Control may also be found under the Holding Company Act if the Bank Board determines that a person, directly or indirectly, exercises a controlling influence over the management or policies of an insured institution. Finally, under either statute, control is conclusively determined to exist upon the acquisition of the power to vote more than 25 percent of the voting shares or securities of an insured institution. Both statutes specifically authorize the Bank Board to issue rules and regulations to carry out their purposes and prevent evasions of them. However, the Board has introduced to the Senate Committee on Banking, Housing and Urban Affairs a proposal to amend the term "control" under the Control Act to clarify the Board's authority to define by regulations that aspect of the term that connotes the power, directly or indirectly, to direct the management or policies of an insured institution. For a more detailed discussion of the scope of the two Acts, please to refer to pages 48686 - 48688 of the Bank Board's new Acquisitions of Control regulations, which are attached to this testimony as Exhibit 26 (50 Fed. Reg. 48686 (1985)).

The substantive criteria set forth in the statute to be used in considering applications under the Holding Company Act are broad and general and focus on whether the financial and managerial resources and future prospects of the acquiring company and the institution to be acquired would cause the acquisition to be detrimental to the institution or to the insurance risk of the FSLIC. In certain acquisitions involving more than one insured institution or where the acquiring company is already a savings and loan holding company, certain anticompetitive factors also must be considered. The Holding Company Act specifically prohibits the Bank Board from approving acquisitions that would have monopolistic results. Nor may the Board approve a proposed acquisition that would substantially lessen competition unless the anticompetitive effects of the transaction are clearly outweighed by a greater service to the convenience and needs of the community. Beyond the foregoing standards, however, consideration of applications under the Holding Company Act involves a significant exercise of judgment and discretion by the Bank Board.

In contrast to the Holding Company Act's approval process, the Control Act review function performed by the Bank Board is expressed in the statute in terms of a disapproval or non-disapproval of a notice filed pursuant to that Act. The Control Act provides that a proposed acquisition may be disapproved by the Bank Board on the following grounds:

1. It would result in a monopoly or be in furtherance of any combination or conspiracy to monopolize the savings and loan business in any part of the country;

2. In any section of the country it would substantially lessen competition, tend to create a monopoly, or be in restraint of trade, and the anticompetitive effects are not clearly outweighed by any benefits in the public interest;

3. The financial condition of any acquiring person is such as might jeopardize the financial stability of the institution or prejudice the interests of the depositors;

4. The competence, experience, or integrity of any acquiring person or any of the proposed management personnel indicates that it would not be in the interests of the depositors or the public to permit such person to control the institution; or

5. Any acquiring person neglects, fails, or refuses to furnish all the information required.

Again, the Subcommittee may refer to Exhibit 26 at pages 48709 - 48711 and pages 48722 - 48723 of the Acquisitions of Control regulations for a more detailed discussion on these approval and non-disapproval criteria.

Through its experience in administering the Holding Company Act and Control Act, the Bank Board has encountered a variety of situations which have proved to be indicative that a potential acquiror may not meet the statutory tests. In an effort to facilitate the review process, the Board's new Acquisition of Control rules set forth certain "presumptive disqualifiers" -- types of legal proceedings or events, which, based on the Board's experience, are indicative that an acquiror may lack the qualifications to acquire control of an insured institution. These "presumptive disqualifiers" put potential acquirors on notice of the grounds upon which an application or notice may be disapproved unless adequately refuted by the acquiror.

"Presumptive disqualifiers" are divided into two types: integrity-related factors and financial factors. In the former category, for example, a prospective acquiror would be presumptively disqualified from acquiring an insured institution if the acquiror had violated any depository institution laws or regulations, housing authority laws or regulations, securities laws or regulations; had sought to acquire a bank or a thrift and been denied permission to do so; controlled or managed a financial institution that failed, or filed false statements with the Bank Board in connection with an application or notice. These presumptive disqualifiers shift the burden to the prospective acquiror to rebut the presumptive disqualification and provide a more manageable procedure for the Bank Board to apply in considering questionable applications. The Subcommittee may refer to Exhibit 26 at pages 48710 - 48711 and pages 48722 - 48723 for additional information.

The Subcommittee has expressed interest in the Bank Board's recommendations concerning possible modifications to the criteria used to review a notice filed under the Control Act, particularly those relating to an acquiror's qualifications to control an insured institution. In this regard, the Board encourages the Subcommittee to consider in its pursuit of possible legislation regarding thrift institutions an amendment to the Control Act to clarify the Board's authority to define further by regulation the terms "competence, experience and integrity." As discussed above, the Bank Board has set forth with specificity in its recently adopted Acquisition of Control rules conduct it believes probative of an acquiror's lack of qualifications to satisfy the statutory standards.

Processing of applications and notices under the two Acts has undergone dramatic changes during the tenure of Chairman Gray . In recognition of the importance of screening applicants to acquire control of insured institutions, the current Board, beginning in the fall of 1983, expanded inquiries and investigations in connection with Holding Company Act applications and Control Act notices, and initiated the project that resulted in the Board's new Acquisitions of Control regulations.

Beginning in the fall of 1983, Chairman Gray directed the Board's staff to initiate procedures to explore thoroughly the background and qualifications of prospective acquirors of insured institutions. Unfortunately, previous practice in many cases had been simply to review the application or notice filed by an applicant, rarely going beyond the information called for by the applicable form. Often little or no independent investigation was made of representations contained in a filing.

Chairman Gray believed at the time that this type of review was totally inadequate and unacceptable. He keenly recognized that the FSLIC would be adversely affected if dishonest or unqualified persons obtained control of insured institutions. Thus, early in 1984, the Board began the use of computerized background checks, liaison with other agencies to verify arrest records and other background information, and the use of targeted questions designed to elicit information concerning legal proceedings and other events which would raise substantial questions concerning an acquiror's qualifications to control an insured institution. The procedures were first implemented by the Board's Washington staff and then were conveyed to the Federal Home Loan Banks through various supervisory memoranda. Thus, under most of Chairman Gray's tenure a new and integral part of review of Holding Company Act applications and Control Act notices has been a focused, independent investigation by Board staff of the background and "track record" of an acquiror.

The Subcommittee has expressed interest in the Bank Board's procedures to elicit information which would raise significant concerns regarding a foreign national acquiror's qualifications to control an insured institution. In addition to the previously described procedures, the Board makes every feasible effort to contact the appropriate foreign law enforcement agency and, if applicable, foreign banking agency to verify a foreign national acquiror's arrest records and other background information. Although the Bank Board's experience in reviewing and processing Control Act notices and Holding Company Act applications from foreign nationals has been limited to date, it has revealed some reluctance on the part of foreign nationals to disclose information about their backgrounds and qualifications to control an insured institution but no lack of cooperation on the part of the foreign agencies to verify background information.

The Bank Board also has evidenced its concern regarding the qualifications of prospective acquirors of insured institutions by denying notices under the Control Act as well as applications filed under the Holding Company Act. For example, since May 1, 1983, four Control Act notices have been formally denied by the Board and over 60 have been withdrawn while staff was in various stages of proceeding to make a denial recommendation to the Board. Before that time no Control Act notices had ever been denied by the Board.

In addition, Chairman Gray actively sought to improve the Board's own procedures and standards for review and processing of Holding Company Act applications and Control Act notices. Over a year ago, the Board directed the staff to proceed with a major project to completely overhaul the Board's regulations governing acquisitions of control of insured institutions. The product of this effort is the Board's recently adopted new Acquisitions of Control rules.

These new rules clarify the application of the Holding Company Act and the Control Act, provide consistent and up-to-date definitions of terms crucial to the application of both Acts, define specifically the situations that constitute an acquisition of control subject to either Act, and introduce a number of new procedures and standards which will enhance the Bank Board's oversight of acquisitions of control of insured institutions. For example, the rules provide a uniform type of public notice of Holding Company Act applications and Control Act notices, thereby enabling the public and, in particular, target institutions themselves to furnish the Board with information that would be relevant in considering a proposed acquisition. This new public comment process will enhance the information available to the Board and improve its review process. For a detailed discussion of these new procedures for processing applications and notices under the new rules, see pages 48705 - 48709 and pages 48718 - 48722 of Exhibit 26. After the Board proposed its rule changes in April 1985, both the FDIC and the Comptroller of the Currency proposed rules to revise their Control Act procedures to allow public comment on Control Act notices.

The Board also has directed its Office of Enforcement to investigate the establishment of a computerized system of records concerning individuals associated with financial institutions, in order to collect information on known or suspected criminal acts and enforcement actions taken. The system also would include information concerning persons receiving major loans from, engaging in significant business transactions with, or applying to acquire control of insured institutions. These measures would be very valuable in making criminal referrals, in examining insured institutions, and, of course, in evaluating applications.

The Board is well aware, however, that establishment of such a system of records must comply with applicable requirements of the Privacy Act of 1974 and certain OMB requirements. The Board intends to establish a workable system that respects individual rights and fully complies with applicable law, and to that end has published a notice of the proposed system of records in the **Federal Register** (Exhibit 27).

In sum, the Bank Board has totally revised its rules and procedures for reviewing applications and notices to acquire control of insured institutions. These actions are important because it is the FSLIC that ultimately is required to pay the price if dishonest or unqualified acquirors obtain control of insured institutions.

Finally, the Bank Board would like to take this opportunity to bring to the Subcommittee's attention a disparity between the Holding Company Act and Control Act with respect to penalties for violations of the statutes and the regulations thereunder. The Control Act only authorizes the Board to assess civil monetary penalties against any person who willfully violates the statutory provisions or regulations. Unlike the Control Act, the Holding Company Act provides for the imposition of criminal penalties against companies for willful violations and against individuals for willful violations or for aiding and abetting willful violations of the statutory provisions and regulations. In addition, the Holding Company Act authorizes the Bank Board to assess civil monetary penalties against any company that violates or any individual that aids and abets a violation of the statutory and regulatory provisions -- whether or not such violation is willful. The term "willfully" is not defined in either the Control Act or Holding Company Act, but the Board, consistent with judicial definitions of the term, generally has interpreted it as encompassing an intentional action by a person that results in a statutory or regulatory violation.

With respect to the Control Act, the Bank Board has found that the lack of a statutory definition for the term "willfully" and the absence of explicit statutory authority to assess civil monetary penalties for statutory and regulatory violations other than those committed willfully has in many cases impaired the Board's ability to enforce effectively the Control Act and the regulations thereunder. In order to eliminate uncertainty in this area and enhance the Bank Board's enforcement of the statutory and regulatory provisions, the Board requests that the Subcommittee consider amendments to the Control Act to provide a definition of the term "willfully" similar to the current interpretation by the Board of that term and comparable penalties as those created under the Holding Company Act. In addition, the Bank Board recommends that the Subcommittee's consideration of amendments to Control Act in this regard include clarification that private rights of action exist under the Control Act and that the Board may seek equitable relief for statutory and regulatory violations, and a description of the procedures to be followed by the Board in assessing civil monetary penalties.

TITLE XI (Right to Financial Privacy Act)

QUESTION

As you know, the Right to Financial Privacy Act gives individuals notice of, and a chance to challenge, Federal government agency requests for their bank records. In 1978 this Committee sought to strike a balance between a customer's right of privacy and the need of law enforcement agencies to obtain financial records pursuant to legitimate investigations. Today, our goals are not any different from what they were in 1978. However, some law enforcement officials have suggested that the 1978 Act is at times an impediment to legitimate law enforcement investigations. Indeed, the Administration's bill, H.R. 2785, would deny the customer's financial privacy protection under the Act under certain circumstances. The Subcommittee would welcome your comments on the experiences you have had with right to financial privacy concerns, and whether in your opinion amendments to the Right to Financial Privacy Act are warranted.

ANSWER

The Right to Financial Privacy Act (RFPA) creates clear impediments to criminal law enforcement efforts. This is particularly troubling when one realizes what the RFPA does not cover, yet it imposes itself on one of the most necessary and sensitive areas of criminal law enforcement efforts -- the referral process.

The RFPA exempts completely each of the Federal financial institutions regulatory agencies for the purposes of conducting our examination and supervisory responsibilities within our respective regulated financial institutions. By an amendment enacted in 1982, the five regulatory agencies also may exchange information among and between one another without violating the RFPA. And the Act has never applied to the transfer of information by any of the regulatory agencies to state and local law enforcement authorities.

Moreover, when an agency has information from the accounts of protected customers under the RFPA, the Act permits it to freely transfer such information to the Justice Department or other appropriate Federal law enforcement authority without prior notice to or approval from the customer. What is required, is notice to the affected customer within ten days after the transfer, that such transfer of information has occurred. This has two clearly deleterious effects: a customer who is involved in the suspected crime may alter records, destroy evidence, or disappear in response to the notice, and the innocent customer (such as a person who does not know that his savings accounts have been manipulated) is shocked by a nearly unintelligible notice (the exact language is mandated in the RFPA) that his records have been transferred to the Department of Justice.

The only alternative to this post-referral notice to customers, is to make the referral in a very abbreviated fashion (without names or back-up documents) to avoid triggering the RFPA requirements. Justice must then issue a Grand Jury subpoena, which is exempt from the customer notice provisions of the RFPA, to obtain the detailed information it requires to properly investigate and prosecute. It is this circuitous and undesirable route that was adopted by the Attorney General's Bank Fraud Working Group with regard to Forms 366 because of the Justice Department's strong belief that customer notices were counterproductive to sound investigative and prosecutorial procedures. (See response to Question 3 above) The Administration's Bill (H.R. 2785) would exempt criminal referrals made by any regulatory agency from the customer notice requirements of RFPA, and is strongly supported by the Bank Board.

"MONEY LAUNDERING BILLS"

QUESTION

As noted above, several bills dealing with money laundering, but having impact on various banking and other statutory law have been referred to the Banking Committee. The Subcommittee intends to review these proposals and would appreciate your comments and analyses of them. The bills we intend to review are: H.R. 2785 (Administration's bill), H.R. 1367 (McCollum), H.R. 1945 (Hubbard), H.R. 1474 (Hughes), H.R. 3892 (Wortley), and H.R. 4280 (Torres).

ANSWER

The Administration's bill (H.R. 2785) contains what we believe are the necessary provisions, i.e., it would make money laundering a crime if done with intent, knowingly, or with reckless disregard for the origin of the unlawful funds. Moreover, as we discussed in this report's section on the Right to Financial Privacy Act (RFPA), the amendment that this bill would provide to the RFPA is clearly needed to allow the flow of information required to combat crime.

The McCollum bill (H.R. 1367) is as acceptable to us as the Administration's bill. However, because it imposes a higher standard on bankers and others (who can be prosecuted if they "have knowledge or reason to know" that they are involved in the conduct of money laundering activity), we anticipate that this bill might meet with great opposition from the banking industry, just as the Bank Bribery Act (18 U.S.C. 215) has, for subjecting "ignorant but innocent" bankers to prosecution. The McCollum bill contains an amendment to the RFPA that should adequately resolve the problems with that act which we discussed earlier.

The four other bills do not contain substantial Right to Financial Privacy Act amendments. Moreover, none of these four are as comprehensive for Bank Secrecy Act purposes as either the Administration or McCollum bills. Therefore, we believe that none of these bills would be adequate for dealing with money laundering or the problems with the RFPA.

EXHIBITS

BANK SECRECY ACT ENFORCEMENT AND RELATED ACTIVITIES
OF THE
FEDERAL HOME LOAN BANK BOARD

APRIL 17, 1986

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1700 G Street, N.W.
Washington, D.C. 20552

Exhibit 1

Federal Home Loan Bank Board

Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

OFFICE OF EXAMINATIONS AND SUPERVISION

AUG 27 1985

The Honorable John M. Walker, Jr.
Assistant Secretary (Enforcement
and Operations)
Department of the Treasury
15th & Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Currency and Foreign
Transactions Reporting Act

Dear Mr. Walker:

The following is a report, covering the period January 1 through June 30, 1985, of our activities relating to the enforcement of the Treasury Department's Financial Recordkeeping and Reporting Regulations (31 CFR Part 103).

I. A. Number of FSLIC insured institutions examined: 861
B. Number of institutions in violation: 4
C. Number and type of violations observed by examiners:

Question No.	Violations
1(b)	40

II. Number of reports of apparent violations received from the Treasury Department or other sources: 0

III. Number of cases referred to Treasury in which assessment of civil penalties were recommended: 1 *

IV. Number of cases referred to Treasury for possible criminal investigation: 1 *

* See enclosure, item 2.

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V. Comments on needs for modification of regulations and/or procedures. 0

Sincerely,

Francis M. Passarelli
Deputy Director
Programs

Enclosure

cc: (1) General Counsel of the Treasury (enclosed)
(2) Richard C. Wassenaar, Assistant Commissioner
(Criminal Investigation)
Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224

OES/FERaue/sep 8/26/85

SUMMARY OF FSLIC INSURED INSTITUTION VIOLATIONS

Violation 1(b)

1. [redacted] Approx. size: $61.6 million.

The institution's March 11, 1985 examination report states that only one IRS Form 4789 had been prepared during the 30-month period under review. It was further reported that a test check of deposits slips for the months of December 1984 and January 1985 disclosed 32 cash deposits of $10,000 or more, most of which appear to have been used to open savings certificates. During the course of the examination the institution's president stated that he would investigate the matter to insure compliance in the future.

Subsequent to the completion of the examination, the president submitted documentation indicating that the transactions in question were not cash transactions but were transfers from maturing certificates of deposits to new certificates of deposits.

This office is now in the process of developing additional information in order to determine the exact nature of the transactions.

2. [redacted] Approx. size: $101.5 million.

Two violations were reported. In one transaction the chairman of the board had institution personnel cash three checks, totaling $41,198.54, wherein the funds were disbursed to a friend who had not endorsed the checks. A currency transaction report was not filed. In the other transaction, the same friend received $10,418.02 from a withdrawal of a certificate of deposit, again wherein no currency transaction report was filed.

Because the violations did not appear to be the result of ignorance or oversight on the part of the association's personnel, this office, on June 25, 1985, referred the matter to you with the recommendation that the association and its chairman of the board be assessed civil penalties of $1,000 each, and also for possible criminal investigation.

3. [redacted] Approx. size: $1.6 billion.

The examiner reported that during September 1983 the association cashed five checks each in excess of $10,000, that it had made out to [redacted] a savings brokerage firm. No currency transaction reports were filed. The transactions are summarized below:

Check Number	Check Date	Date Cashed	Amount
304970	9-09-83	9-09-83	$18,249.87
304986	9-13-83	9-13-83	13,820.84
341878	9-19-83	9-19-83	19,328.00
342212	9-21-83	9-22-83	10,641.48
342233	9-23-83	9-23-83	11,440.43

The forms were ultimately filed in January 1985.

4. [redacted] Approx. size: $17.4 million.

The association failed to file a currency transaction report for a $12,000 cash deposit received on November 16, 1984 from a customer purchasing a one-year certificate of deposit. The managing officer advised the examiner that association personnel would be made aware of the requirements of the regulation and that the currency transaction reports would be filed as required. The association stated that the report for the $12,000 deposit was filed in January 1985.

Additional Comments

1. [redacted] Approx. size: $2.8 billion.

On April 3, 1985, David D. Queen, Deputy Assistant Secretary (Enforcement), Department of the Treasury, advised this office that the IRS had been authorized to conduct an investigation at this association. In order to preclude any interference with the investigation, we were requested not to examine the association until further notice. However, an examination was in process at that time. Subsequently, by telephone, this office advised Mr. Robert Stankey, of your enforcement office, that the examination had been completed and that certain money laundering activities had been disclosed.

The following is taken from the association's examination report as of March 27, 1985:

Currency and Foreign Transactions Reporting Act

Discussions with Vice President [redacted] revealed that the association was apparently involved in the "laundering" of illicit funds through its branches in [redacted]. On September 26, 1984, $121,000 was laundered through three [redacted] branches and $100,000 through three [redacted] branches on November 28, 1984. The laundering scheme was apparently orchestrated by one person, who along with approximately three other individuals, purchased money orders with cash. Each money order was issued in blank for amounts less than $10,000.

The association's regional manager in [redacted] was apparently not aware of any suspicious activities. However, the association's regional manager in [redacted] was apparently aware of suspicious activities he encountered on November 28, 1984, as he reported the need to tighten the association's policies in regard to reporting currency and foreign transactions to Senior Executive Vice President [redacted] several times. Vice President [redacted], who is the association's security officer, states that on February 28, 1985, he learned details of the suspicious activities in [redacted], only after questioning the association's [redacted] regional manager. Vice President [redacted] states that as soon as he learned the details of this suspicious activity, he reported the details to the Internal Revenue Service (IRS) and the Federal Bureau of Investigation. Vice President [redacted] further states that the IRS did not and has not requested the association to submit Form 4789 after being informed of this apparent "laundering" scheme. Vice President [redacted] informed the IRS that the association would not be submitting IRS Form 4789, as there was not sufficient information to complete the form, but the association would cooperate and provide all available information.

Vice President [redacted] states the association periodically sends directives to its regional and branch managers to continually inform them of the association's policy in regard to the reporting of currency and foreign transactions. He further states that regional and branch managers have been instructed to report any suspicious activities, not to issue cashiers checks or money orders to anyone who is not a customer of the association, and not to issue money orders in blank, as a means of preventing any further reporting problems.

Chairman of the Board [redacted] concurs with the comment, and states that additional checks have been made by the association and that no other related transactions were found.

Exhibit 2

The Honorable John M. Walker, Jr.
Assistant Secretary (Enforcement
  and Operations)
Department of the Treasury
15th & Pennsylvania Avenue, N.W.
Washington, D.C. 20220

8 APR 1986

Currency and Foreign
Transactions Reporting Act

Dear Mr. Walker:

The following is a report, covering the period July 1 through December 31, 1985, of our activities relating to the enforcement of the Treasury Department's Financial Recordkeeping and Reporting Regulations (31 CFR Part 103).

I. A. Number of FSLIC insured institutions examined 947
B. Number of institutions in violation: 6*
C. Number and type of violations observed by examiners:

Question No.	Violations
1(c)	6

II. Number of reports of apparent violations received from the Treasury Department or other sources: 4

The Treasury Department advised us that it had authorized IRS to undertake an investation of possible criminal violations of 31 CFR Part 103 at:

a) [redacted]

*See enclosure for summary of violations.

The Honorable John M. Walker, Jr.
Page 2

b) [redacted]

c) [redacted]

d) [redacted]

III. Number of cases referred to Treasury in which assessment of civil penalties were recommended: 0

IV. Number of cases referred to Treasury for possible criminal investigation: 0

V. Comments on needs for modification of regulations and/or procedures. 0

Sincerely,

/S/
Edward J. Taubert
Associate Director, Policy Development

Enclosures

cc: (1) General Counsel of the Treasury (enclosed)
(2) Richard C. Wassenaar, Assistant Commissioner
(Criminal Investigation)
Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224

OES/FE[illegible]aue/sar/4.4.86

SUMMARY OF FSLIC INSURED
INSTITUTION VIOLATIONS

Violation 1(c)

1. [redacted] Approx. size: $118 million.

   For the institution's July 8, 1985 examination, the examiner reported that [redacted] does not maintain a list or other record of those customers whose transactions have been exempted from the requirements of Section 103.22(e). It was further reported that the institution "has numerous business checking account customers and provides a receipt pick-up courier service through its service corporation. Consequently, numerous currency transactions may have been exempted." The board chairman "stated that a resolution was adopted at the August 15, 1985, Directors' meeting requiring full compliance with the Currency and Foreign Transactions Reporting Act."

2. [redacted] Approx. size: $20.0 million.

   The examiner reported that, "The association has not been maintaining its log of exempt customers nor does it contain all of the required information set forth in Section 103.22(e) of the Act. In addition, not all of the transactions requiring the preparation of Form 4789 were reported. The association had a local auto dealer as an exempt customer; these large transactions should have been reported."

   Management stated that it will take immediate steps to correct these deficiencies.

3. [redacted] $430.0 million.

   The examiner reported that the "association is not in compliance with the provisions of the Currency and Foreign Transactions Reporting Act (the Act). There were no formal written policies or procedures, nor internal audit procedures or controls necessary to determine compliance with the reporting requirements. The following deficiencies were noted:

   1. A verification of records, and statements made by management, revealed that no record was maintained at the branch offices or the main office citing those customers whose transactions have been exempted from reporting requirements.

Page 2

2. From 4789 is not being prepared at the main office.

3. There was no evidence that the 4789 forms were ever sent to the Internal Revenue Service as required by Section 103.25 of the Act.

4. A review of all available 4789 forms (eight) showed that branch personnel did not obtain the business, occupation, or profession data from the customer in six cases; and in two instances, the account number of the customer was missing.

"During the course of the examination ... (the) Senior Vice President submitted a detailed policy to the examiners, dated September 24, 1985, outlining all of the currency transaction procedures, forms, reporting requirements, etc., to be followed by all officers and personnel."

4. [redacted] Approx. size: $4.3 billion.

The examiners reported that they "were only able to identify one exempted transaction, while determining that a proper listing procedure has not been developed for utilization by the employees. Management has agreed to correct this deficiency."

5. [redacted] Approx. size: $39.8 million.

For the July 15, 1985 examination, the examiner stated that the "association has not maintained a list of customers whose transactions have been exempt from the requirement of Section 103.22(e) of the Currency and Foreign Transactions Reporting Act."

The Vice President stated "that they do have some exempt customers, but that a list of such customers has not been kept. She has instructed all branch operation offices to comply with the Regulation."

6. [redacted] Approx. size: $2.7 billion.

The examiner reported that the "examination of the [redacted] disclosed several deficiencies in the policy concerning the reporting of large currency transactions which resulted in noncompliance with FHLBB Memorandum T 53-7." The deficiencies include a failure to maintain a list of exempt customers.

A division manager stated that representatives from the Training Branch Operations, Security and Internal Audit, will meet the week of October 21, 1985. They will formulate and implement a specific corrective action plan so as to achieve 100 percent compliance with the Bank Secrecy Act.

He further stated that the corrective action plan is to be delivered to him no later than November 1, 1985, with implementation to occur the week of November 4, 1985.

Additional Comments

[redacted] Approx. Size: $61.2 million

For the examination dated as of September 6, 1985, the examiner reported that she only noted some technical deficiencies. However, she did report on a contingent liability relating to existing lawsuits concerning possible violations of various sections of Title 31, U.S.C. Copies of the examination report comments are attached.

Attachment

[illegible]

QUALIFIED OPINION BY INDEPENDENT AUDITORS

Contingent liability relating to existing lawsuits and a continuing investigation into possible violations of the provisions of Title 31, U.S.C. Sections 1059, 1081 and 1101 by a number of [redacted] financial institutions caused [redacted] to render a qualified opinion as to the financial condition of the association at June 30, 1985. These matters are discussed below:

1. Large Currency Transactions ("Operation Greenback") Investigation

During the previous examination Grand Jury subpoenas had been served on the board of directors and the association for various records pertaining to large currency transactions. The law firm of [redacted], P.A., represents the association in this matter. The attorneys state that the investigation is continuing. A copy of the August 15, 1985 letter from the law firm addressed to [redacted] was submitted to the examiner as part of [redacted] attorney's report. Excerpts from the letter are:

> "Following a review of the information we have gathered and analyzed to date, we have not found a sufficient basis that the Company has wilfully violated 31 U.S.C., Sections 1059, 1081, or 1101, and absent of finding of such wilful violations, no liability exists under those sections or the applicable regulations. However, our investigation is continuing and is incomplete."
>
> "As a result of the foregoing, we cannot state that it is probable that the Government will indict the Company for violating Title 31, U.S.C., Sections 1059, 1081 and 1101. Neither can we state that it is not likely. If the Government does indict the Company, it is the Company's intent to vigorously defend itself."

During the current examination a review of Large Currency Transaction Reports revealed only technical deficiencies. In addition, the review of a sample of tellers' work for eight randomly chosen days revealed that all required reports had been filed.

2. Litigation with [redacted]

In a complaint served on October 5, 1984, [redacted], as plaintiffs, seek compensatory damages in excess of $5,000 and punitive damages in excess of $10,000,000. The suit is based on [redacted] claim that the association promised him that his position as managing officer would be reinstated with back pay upon acquittal from his indictment related to irregularities in large currency transactions. [redacted] is seeking in excess of $100,000 alleging negligence on the part of the association related to her husband's arrest and trial.

The [redacted] have defaulted on their home mortgage obligation to [redacted] and a foreclosure action is in process. The outstanding principal balance is $93,678 and interest has not been paid since April, 1983.

Attorneys for the association, [redacted]., are unable to render an opinion as to the outcome of the litigation at this time but state that it is unlikely that judgment in the amount demanded for punitive damages would be granted.

3. Litigation with [redacted]

[redacted] is alleging negligence and breach of contract and seeking compensatory and punitive damages in an unspecified dollar amount related to her indictment during the government investigation of large cash transactions while she was employed as a teller by the association in 1982. She was indicted, tried, and subsequently acquitted. She claims the association promised her that her position would be reinstated with back pay if she were acquitted. On January 2, 1985, the association filed a Motion to Dismiss which has not yet been heard. Counsel states that it is unable to render an opinion as to the outcome of this action.

4. Litigation with [redacted]

[redacted] a former depositor, alleges that the association allowed an unauthorized withdrawal from her certificate of deposit account in the amount of $50,000. According to Executive Vice President [redacted] the funds were withdrawn in an attempt to retrieve $50,000 lost when one deposit was entered twice in a related party's account, and which account was closed prior to discovery of the error by the then-managing officer, [redacted] The case has gone to trial and the judge struck the plaintiff's petition for punitive damages and attorneys' fees. He had not ruled on the question of damages for the unauthorized withdrawal at the time of the examination.

Counsel for the association did not give an opinion as to the outcome of this case.

5. Loss Reserves

No reserves have been established to protect against these contingent liabilities.

President [redacted] provided the following response to the examiner's comments:

5. Loan Reserves - continued

MANAGEMENT QUESTIONNAIRE

October 7, 1985 Re:

Ms. Ruth Meacham
Examiner-In-Charge
Federal Home Loan Bank Board
Miami, Florida

MANAGEMENT RESPONSE

Qualified Opinion by Independent Auditors

1) Large Currency Transactions ("Trechbacks") investigation.

As stated on the institutions attorney's [redacted] letter of opinion, regarding the above case, management opinion is based that the institution has not willfully violated 31 U.S.C., Sections 1059, 1081, or 1101 and since the former officer and employee of the Association indicted, were acquitted from those charges the management believes that government will let the case to be dormant until status of limitation expires sometime in November, 1987.

Large Currency Transactions Reports

Management will continue its efforts to assure that CTR reports be filed complete without any blank spaces left out.

Litigation with [redacted]

Management will not give an opinion as to the outcome of this case, since ruling from the court is expected in a few weeks.

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5. Loss Reserves - continued

MANAGEMENT QUESTIONNAIRE

October 7, 1985 Re: F.H.

Ms. Ruth Meacham
Examiner-In-Charge
Federal Home Loan Bank Board
Miami, Florida

MANAGEMENT RESPONSE

Litigation with [redacted]

[redacted] as plaintiffs, seek compensatory damages in excess of $5,000.- and punitive damages in excess of $10 million, based on [redacted] claim that the Association promised him that his position as managing officer would be reinstated with back pay upon acquittal from his indictment related to irregularities in large currency transactions. It is the managements opinion that the institution will not be liable for any compensation to [redacted] since the institution does not have an employee contract with [redacted] and the Board Company deleted him from insurance coverage.

Litigation with [redacted]

In Management opinion, no liability will arise from the outcome of the litigation since no employee contract exists between the institution and the plaintiff.

January 8, 1986

FHLBB No. 7506

Board of Directors
[redacted]

Members of the Board:

We are enclosing a copy of the annual report of examination of your association made as of September 6, 1985, by examiners of the Federal Home Loan Bank of Atlanta.

We direct the board of directors' attention to the examiner's comments concerning contingent liability relating to existing lawsuits and a continuing investigation into possible violations of the provisions of Title 31, U.S.C. Sections 1058, 1081 and 1101 found on pages 2.1 and 2.2 of the examination report. Please keep us apprised of the status of each of these disputes and assure us that, in the event an unfavorable outcome is likely, the association will establish necessary reserves.

The examiner's comments concerning transactions with affiliated persons are found on pages 2.5 through 2.7 of the report. As indicated by the examiner, the loans granted to Chairman [redacted] and associated companies, and a number of loans to third parties were in violation of Sections 563.43(b)(5) and (c)(2) of the Insurance Regulations. The numerous violations of this nature evidence a disregard or apparent lack of understanding on the association's part of Federal Home Loan Bank Board regulations concerning conflicts of interest and transactions with affiliated persons.

If you are not already aware, paragraph (b)(5) of the above-referenced regulation provides that an insured institution may extend credit for commercial purposes to an affiliated person which may in no event exceed an aggregate of $100,000. With respect to extensions of commercial credit exceeding an aggregate amount of $10,000, the loan must be approved by a resolution duly adopted after full disclosure, by at least a majority (with no director having an interest in the transaction voting) of the entire board of directors. Full disclosure must include whether the loan is made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable loans to members of the general public. In addition, at the time of approval by the board of directors, the association must notify the Supervisory Agent of the transaction and all other outstanding extensions of credit to the affiliated person.

Exhibit 3

9

SUBJECT	THE BANK SECRECY ACT
LESSON OBJECTIVE	To familiarize the examiners with the regulation and their responsibilities relative to diagnosing any possible violations pertaining to money laundering.
TOTAL TIME	1 Hour
INSTRUCTIONAL METHOD	Lecture
STUDENT MATERIAL	References contained in student manual with additional reading material.
REFERENCES	(1) Forms 4789, 4790 (Treasury Dept.) (2) Form 919 FHLBB (3) Interim Report to President and Attorney General "The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering. (4) If you notice suspicious Currency Transactions

CONTENT OUTLINE	INSTRUCTOR'S PRESENTATION

A. Overview of the Currency and Foreign Transactions Reporting of 1970

1. Purpose of this presentation intended as a general summary of the rules relating to reporting and recordkeeping currency transactions.

2. Those affected by Act and Regulations

    - (a) Commercial banks or trust companies
    - (b) Private banks
    - (c) Savings and Loan Institution
    - (d) Federally - insured institutions
    - (e) Credit Unions
    - (f) Organizations chartered under banking laws of the States.
    - (g) Representatives of foreign banks located in the United States
    - (h) Brokers and dealers in securities
    - (i) Dealers in foreign exchanges
    - (j) Issuers of travelers' checks and money orders
    - (k) Credit card system
    - (l) Those who transmit funds abroad for others

2. Those not affected by the Act and Regulations

    - (a) Branches located outside the United States

(b) Not foreign banks or branches no located in the United States

4. Does it impact individuals as well as corporate and other legal personalities?

    (a) Yes under certain circumstances relative to transactions in and transportation of circulating coins and currency, traveler's checks, money orders, investment securities and negotiable instruments in bearer form.

    (b) Some of the requirements relate to transactions between persons in the United States and in foreign countries, and others which relate to purely domestic transactions.

B. Reports of Currency Transactions by Financial Institutions (Form 4789)

1. Definition

    (a) When any person engages in a currency transactions of more than $10,000 with a financial institution; the financial institution must record the identity of the person or persons involved and file a report containing certain details of the transaction within 15 days (Regulations Sections 103.22, 103.25(a) and 103.26)

2. Features common to money laundering schemes and the purposes and importance of the Bank Secrecy Act where illegally obtained cash is brought into an institution or certain actions which are characteristic of money laundering such as "spreading" and "splitting" transactions in a single day

    (a) An individual who makes large cash deposits when the business of that individual or his corporation's not a type known to generate substantial amounts of cash; -

(b) A person whose individual or corporate accounts show virtually no normal business-related banking activities and who uses those accounts primarily as a temporary repository for funds ultimately transferred to foreign bank accounts;

(c) Corporate accounts whose transactions, both deposits and withdrawals, are dominated by cash rather than by forms commonly used in commercial transactions, such as checks, loan proceeds, letters of credit, or banker's acceptances;

(d) A customer who provides minimal or fictitious information, or information that the financial institution cannot readily verify, concerning such matters as property ownership, credit history, or sources of income, particularly when the provision of such information would make the customer eligible for credit line or additional banking services that a legitimate customer would find valuable;

(e) An individual engaging in numerous cash transactions, or purchasing cashier's checks, in amounts just below the $10,000 threshold for completion of CTR's;

(f) A customer who maintains an inordinately large number of accounts not commensurate with the type of business purportedly being conducted, and/or who engages in an inordinately large number of fund transfers between these accounts;

(g) A customer who makes regular large cash deposits or withdrawals associated with wire transfer to, from, or through narcotics source or transit countries, or whose secrecy laws have been known to facilitate the laundering of the proceeds of narcotics trafficking; and

(h) In the case of a currency exchange, a customer who uses the exchange's services to wire cash without changing the form of the currency (e.g., U.S. dollar transfers).

3. While these characteristics may also be observed in the context of wholly legitimate transactions, they can provide financial institutions and economics with at least some guidance relative to identifying a problem or exercising some monitoring controls.

   (a) Exemptions are permitted for various types of business such as eateries, etc.

      (1) There must be an awareness .. corrupting officials relative obtaining exempting status.

4. To facilitate the review process contact with the Treasury Department should be inside to obtain the latest listing of Currency Transaction Reports (CTRs) and Currency or Monetary Instruments Reports (CMIRs) that have been received by the Department of the Treasury from particular financial institutions of a particular region or district. In addition, a listing of exemptions can be obtained.

C. Reports of Transportation of Currency or Monetary Instruments by Persons (Form 4790)

1. Definition

   (a) Any person who is responsible for the physical transportation of more than $5,000 in currency or certain monetary instruments at any one time into or out of the United States must file a report there of at the time of departure mailing or shipping. (Regulation Sections 103.23(a) and 103.25(b)).

   (b) The receipt of currency or certain monetary instruments in amounts exceeding $5,000 from outside the United States, by a person within the United States must be reported within thirty (30) days after such receipt (Regulation Sections 103.23(b) and 103.25(c)).

D. Reports of Interest in Foreign Financial Accounts by Persons (Form 9-22.1)

1. Definition

   (a) A person subject to the jurisdiction of the United States who is required to file a Federal income Tax return must indicate on the tax form whether or not they have any interest in foreign Financial Accounts. If there is, a short form giving information about such accounts must be filed.

   (b) The records of such accounts are to be returned for five (5) years and shall be available for inspection (Regulation Sections 103.24 and 103.32).

E. Financial Recordkeeping and Reporting Regulations (Examiner Checklist Federal Home Loan Bank Board Form 919)

1. The examiner should provide, in the examination workpapers and/or in the report of examination, details of apparent violations necessary for reporting to the Department of the Treasury.

2. The examiner should determine:

   (a) That the institution has established an adequate system for indentifying and reporting covered transactions.

   (b) That the employees who normally come into contact with the converted transactions are properly instructed relative to reporting responsibilities.

3. Examiner is responsible for filling out the form or making sure it is properly filled out and reviewed for necessary and proper follow-up reporting any determined deficiencies.

F. Recordkeeping by Financial Institutions

1. Definition

   (a) financial institutions are required to retain for five (5) years either the original or a copy of:

      (1) records of extentions of credit exceeding $5,000 except those secured by rent property;

      (2) records of each advice request or instruction received regarding is transaction resulting in the transfer of more than $10,000 to a person, account, or place outside the United States;

      (3) records of each advice, request or instruction given to another financial institution or other persons located within or outside of the United States, regarding a transaction intended to result in the transfer of more that $10,000 to a person, account or place outside the United States (Regulation Sections 103.36(c)).

President's Commission on Organized Crime

Interim Report to the President
and the
Attorney General

THE CASH CONNECTION:
Organized Crime, Financial Institutions, and Money Laundering

RECOMMENDATIONS

In light of the foregoing facts and conclusions, the Commission believes that the following recommendations are worthy of detailed further examination:

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A. Voluntary Guidelines for Financial Institutions

The Commission has formulated voluntary guidelines which financial institutions can adopt in response to the problem of money laundering. They were developed after interviews with officials of financial institutions, reviews of several bank internal policy manuals, and observance of routine daily operations in a wide variety of financial institutions. The proposals take into account distinctions between individual institutions, such as their size, number of branches, and amount of commercial activity. In some instances, proposals are drawn from procedures already implemented in banks and considered by the Commission to be a model for other institutions. However, these proposals are not intended to be a policy manual or "how-to" guide, but are intended to alert responsible officials to possible shortcomings in their institutions' internal policies.

1. Party Responsible for CTR Completion

In reviewing the internal procedures of several banks, the Commission found that there are significant differences between methods of completion and filing of CTRs. In some circumstances the teller to whom cash is presented completes the form; in others, a specific teller is designated to handle large currency transactions and complete forms; in yet others, the branch manager is responsible for completion of the form and filing the report with the central bank office. In most procedures, however, only one employee is required to sign the CTR.

The branch manager or assistant manager should be ultimately responsible for completion of the CTR, and be required to countersign the CTR. This procedure should guarantee the thoroughness of information on the form, and ensure that the report is properly channeled within the institution prior to its filing with the IRS. In addition, institutions may increase their ability to detect suspect financial activity by designating a "risk management officer"—a mid-level manager who is ultimately responsible for activity within a specific sector of the bank's operation—to review all completed and countersigned CTRs.

2. Training for Officers and Employees

The Commission found that the amount of time devoted to teller training on Bank Secrecy Act compliance is usually less than one hour, with tellers instructed only in the most elementary requirements of the law and regulations.

Tellers should receive more extensive training, not only in the requirements of the regulations, but in the features common to money laundering schemes and the purposes and importance of the Bank Secrecy

Act. Minimal training and preparation should expose the teller to potential situations where illegally obtained cash is brought into the bank, and to actions which are characteristic of money laundering schemes, such as "spreading" and "splitting" transactions in a single day.

In particular, tellers and the officers or employees who directly supervise them should be specifically instructed to recognize certain characteristics of customers who may be engaging in money laundering:

- An individual who makes large cash deposits when the business of that individual or his corporation is not of a type known to generate substantial amounts of cash;
- A person whose individual or corporate accounts show virtually no normal business-related banking activities and who uses those accounts primarily as a temporary repository for funds ultimately transferred to foreign bank accounts;
- Corporate accounts whose transactions, both deposits and withdrawals, are dominated by cash rather than by forms commonly used in commercial transactions, such as checks, loan proceeds, letters of credit, or banker's acceptances;
- A customer who provides minimal or fictitious information, or information that the financial institution cannot readily verify, concerning such matters as property ownership, credit history, or sources of income, particularly when the provision of such information would make the customer eligible for credit lines or additional banking services that a legitimate customer would find valuable;
- An individual engaging in numerous cash transactions, or purchasing cashier's checks, in amounts just below the $10,000 threshold for completion of CTRs;
- A customer who maintains an inordinately large number of accounts not commensurate with the type of business purportedly being conducted, and/or who engages in an inordinately large number of fund transfers between these accounts;
- A customer who makes regular large cash deposits or withdrawals associated with wire transfer to, from, or through narcotics source or transit countries, or countries whose secrecy laws have been known to facilitate the laundering of the proceeds of narcotics trafficking; and
- In the case of a currency exchange, a customer who uses the exchange's services to wire cash without changing the form of the currency (*e.g.*, U.S.-dollar-to-U.S.-dollar transfers).

While these characteristics may also be observed in the context of wholly legitimate transactions, they can provide financial institutions with at least some guidance on the steps that they can take to discourage money laundering.

3. Internal Auditing Function

Many financial institutions, including banks and savings and loan associations, have internal audit groups to examine their routine functions and activities. However, no institution reviewed by the Commission has an audit unit devoted solely to Bank Secrecy Act compliance, and the enormous number of technical violations discovered during government compliance checks clearly indicates that far too little attention is given to this area.

To aid in their self-review for compliance with the Act, financial institutions should implement an internal clearinghouse for all CTRs and CMIRs generated in branch commercial activity. Such an internal function would enable management to review compliance efforts at an early stage.

4. Exemption Lists

When customers wish to be exempted from the Act's reporting requirements, financial institutions should perform background investigations which are as thorough as those performed on loan applicants. Special attention to the customer's business needs and the proposed upper range of exempt currency transactions is a necessity. If an exemption is to be granted to a customer, this decision should be approved by at least two officers of the financial institution, reducing opportunities to corrupt officials in furtherance of a laundering scheme.

5.- Fiduciaries

Internal auditors should give particular attention to activities that frequently evade cursory review, such as the purchase and cashing of large-denomination cashier's checks and deposits or exchange of large amounts of currency by a person in an agency or fiduciary relationship with the principal or account holder. Because this practice has occurred in documented money laundering schemes, review of such transactions should be expanded to reveal patterns of suspicious activity.

6. Electronic Data Processing

The Department of the Treasury and the financial community should undertake a joint study to determine the feasibility and cost of on-site electronic data processing of Bank Secrecy Act reporting forms. The current processing system creates a significant lag between the time of a suspicious financial transaction and the time at which this information is available to investigators.

7. Notification to Law Enforcement Agencies

Financial institutions should establish a formal policy that encourages their officers and employees to report promptly to the appropriate law enforcement agencies all transactions suspected of involvement with money laundering. Such a policy should recognize the need of law enforcement agencies to receive such reports as soon as possible during or after the transactions, as well as the duty of the institution to act in conformity with Federal and state law governing the financial privacy of its customers. In implementing such a policy, each financial institution should provide specific guidelines to its tellers and branch supervisors for identifying such transactions.

B. Administrative Recommendations

1. To increase substantially the costs and difficulties associated with the conduct of money laundering, and to deter money launderers in the United States from using foreign countries so freely for money laundering, the Department of the Treasury should determine which countries are most likely to be repositories for significant amounts of laundered money, by combining a country-by-country analysis of CTRs, CMIRs, and Foreign Bank Account Reports (FBARs) with investigative information obtained from various Federal agencies. Thereafter, the Department of Justice should expand on its use of Financial Task Forces and develop teams of United States Attorneys, other Department of Justice attorneys, and investigative agencies to coordinate their investigations and prosecutions of money launderers on a country-by-country basis, to target the foreign countries most heavily used for money laundering from the United States.

2. To increase the effectiveness with which the IRS can review financial transactions for compliance with the Bank Secrecy Act, and to ensure that financial institutions have a specific Federal agency to contact if they become aware of violations of the Bank Secrecy Act, the Secretary of the Treasury (through the IRS) should be given substantial additional personnel, devote those personnel (including both Revenue Agents and Special Agents) and resources (including civil summons power) to the IRS office that handles Bank Secrecy Act compliance, and designate that office as the initial contact for financial institutions.

3. To complement the efforts of the Department of the Treasury to assure compliance with the Bank Secrecy Act, andto facilitate the efforts of the FBI and the DEA to investigate other money laundering-related violations within their respective jurisdictions, the Attorney General (through the FBI and the DEA) should be given substantial additional personnel and devote those personnel to investigations of such violations.

4. To reduce the time that is required to process and analyze CTR data, the Secretary of the Treasury should consolidate the processing of such data into a single location.

5. To expedite the process by which financial institutions can inform law enforcement agencies of specific violations of the reporting requirements under the Bank Secrecy Act, the Secretary of the Treasury and financial institutions should coordinate the implementation of a procedure whereby a financial institution can make a special standardized notation on any CTR or CMIR that it believes involves a questionable transaction, mail that CTR or CMIR, as appropriate, to the IRS or Customs office responsible for inputting such data, and telephone a particular office (such as the IRS compliance office) to alert it to the contents of the CTR or CMIR. Such a procedure would in no way conflict with the provisions of the Right to Financial Privacy Act, and can quickly call the attention of law enforcement agencies to a possible money laundering scheme, as the Orozco case demonstrates.

6. To facilitate review for Bank Secrecy Act compliance during audits of financial institutions, the Secretary of the Treasury should arrange for the generation of exemption lists compiled by financial institutions, as well as lists of CTRs and CMIRs that have been received by the Department of the Treasury from particular financial institutions, and for the transmission of those lists to bank examiners or other auditors in advance of their audits of those institutions.

7. To discourage officials or employees of a financial institution from abusing that institution's authority to exempt customers from the requirements of the Bank Secrecy Act, the Secretary of the Treasury should amend the Department of the Treasury's regulations under the Bank Secrecy Act to establish the following procedure: (1) the customer requesting the exemption would be required to complete and sign a sworn statement (falsification of which would violate 18 U.S.C. §1001), on a form provided by the Department, that sets forth all of the information concerning the exemption that the financial institution is currently required to maintain, as well as the information that the customer has provided to the institution in support of the request for the exemption, (2) the financial institution would be required to submit the form to the

Department within seven working days after the customer has completed and signed the form.

8. To minimize the possibility, in situations where a law enforcement agency has requested information from a financial institution concerning a customer, that disclosure of the agency's request might result in the destruction of evidence or other impediments to the agency's investigation, the agency should request that the financial institution not disclose the agency's request for information to the customer until the agency has provided the customer with the notice required under the Right to Financial Privacy Act. In those instances where the agency has obtained a judicial delay in notice under section 1106(c) or 1109(a) of the Right to Financial Privacy Act, and an official or employee of the financial institution notifies the customer of the agency's request for information during the pendency of that delay, the Department of Justice should consider criminal prosecution of that official or employee under Chapter 73 of Title 18, United States Code (concerning obstruction of justice), if the notification to the customer results in one of the circumstances described in section 1109(a)(3) of the Right to Financial Privacy Act.

9. To discourage the use of casinos by criminals as conduits for money laundering, and to subject casinos, where appropriate, to the reporting and recordkeeping requirements of the Bank Secrecy Act, the Secretary of the Treasury should amend the regulations under the Act to include casinos in the definition of "financial institutions." (While the Commission endorses such an inclusion, as the Department of the Treasury has proposed in its recent notice of proposed rulemaking, the Commission offers no additional comment at this time on any other aspect of that notice.)

10. To improve communications between the Department of the Treasury and bank supervisory agencies concerning Bank Secrecy Act compliance, and to encourage those agencies in their efforts to ensure such compliance, the Department of the Treasury should formally notify a bank supervisory agency that has referred a case to the Department for investigation of possible criminal violations of the Act, if the referral results in the filing of an indictment or information. In appropriate cases, the Department of the Treasury should also formally express its appreciation to any employee or unit of the bank supervisory agency whose work significantly contributed to the referral.

C. Legislative Recommendations

(Note: As this report went to print, the House of Representatives, on October 11, 1984, passed legislation, H.J. Res. 648, containing, either in whole or in part, recommendations 4, 6, 7, 9, and 10, marked with asterisks on the following pages.)

1. To permit financial institutions to cooperate more actively and regularly with Federal law enforcement agencies in providing information concerning ongoing money laundering schemes, Congress should amend the Right to Financial Privacy Act. Such an amendment should permit those institutions not only to notify the agencies that they have information which may be relevant to a violation of law, but also to disclose a sufficient amount of such information to permit the agencies to determine whether a formal investigation is warranted and how such an investigation should proceed. Such an amendment could be drafted so that all subsequent disclosures of information in customers' financial records could be made only in conformity with the provisions of the Right to Financial Privacy Act. (See Appendix.)

2. To clarify the law concerning Federal agencies' rights of access under state law to the financial records of financial institutions' customers, Congress should also amend the Right to Financial Privacy Act to preempt the provisions of any state constitution, statute, regulation, or judicial decision that create a more stringent standard for financial institutions' disclosures to Federal agencies than the Act does. (See Appendix.)

3. To ensure that financial institutions will not inadvertently render themselves subject to private damage actions under the Right to Financial Privacy Act for disclosing information to law enforcement agencies concerning violations of law, or for failing to notify customers of such disclosures, Congress should amend the Right to Financial Privacy Act. Such an amendment should permit an institution to raise as a defense that it had disclosed the information in a good-faith belief that it may be relevant to a possible violation of a statute or regulation. (See Appendix.)

4.* To increase the incentive for officials or employees of financial institutions or other persons to inform Federal agencies that money laundering is taking place at a particular institution, Congress should add a provision to the Bank Secrecy Act that would permit the Secretary of the Treasury to give rewards for information leading to penalties under the Bank Secrecy Act. (See Appendix.)

5. To facilitate the process by which the Department of the Treasury may transfer information in reports filed under the Bank Secrecy Act to other Federal agencies, Congress should amend the Bank Secrecy Act. Such an amendment would permit the Secretary of the Treasury to

transfer information in those reports not only when the head of an agency specifically requests such information in connection with a formal open investigation by that agency, but also when the Secretary has reason to believe that making such information available to an agency, even if not specifically requested by that agency, would further or facilitate the exercise of the Secretary's supervisory or regulatory powers under the Bank Secrecy Act. (See Appendix.)

6.* To facilitate the investigation of money laundering schemes by making possible the interception of telephone calls, telexes, and other forms of wire or oral communication in accordance with the provisions of Title III of the Omnibus Crime Control and Safe Streets Act of 1968, Congress should amend Title III to include the criminal provisions of the Bank Secrecy Act as a predicate for the issuance of judicial orders authorizing such interceptions. (See Appendix.)

7.* To increase the effectiveness of the civil penalty in the Bank Secrecy Act, Congress should amend the Act to increase the maximum civil penalty under the Act from $1,000 to $10,000, except for cases involving a willful violation of any reporting requirements, in which the fine should equal the amount of the monetary instruments. (See Appendix.) In determining the amount of the penalty to be levied against a domestic financial institution, or a partner, director, officer, or employee thereof, for a willful violation of the Act, the Secretary of the Treasury should take into account whether the institution has adopted formal procedures for ensuring compliance with the Act, as well as the scope and detail of such procedures and the vigor with which the institution applies and enforces them. In addition, the Secretary should arrange for public announcements, through the office of public information at the Department of the Treasury, whenever the Department institutes or concludes a proceeding for the imposition of a civil penalty under the Act.

8. To increase the effectiveness of the criminal penalties in the Bank Secrecy Act, Congress should amend the Act to (1) increase the maximum criminal fine from $1,000 in all cases to the greater of $250,000 or twice the amount of the monetary instruments for the first such offense, and to the greater of $1,000,000 or five times the amount of the monetary instruments for each subsequent offense; (2) increase the maximum term of imprisonment from one year in all cases to five years for the first such offense, and to ten years for each subsequent offense; and (3) make the enhanced criminal penalties applicable in cases where the person committing the offense has done so as part of a pattern of illegal activities that include, but that are not limited to, violations of the Act or the regulations thereunder. (See Appendix.)

9.* To discourage and to penalize more heavily the corruption of officers or employees of financial institutions by money launderers, Congress should amend Sections 215 and 216 of Title 18 so that the penalty for the use of bribery or graft concerning financial officials can be increased from a misdemeanor to a felony. (See Appendix.)

10.* To facilitate the apprehension of money launderers who seek to transport large amounts of currency from the United States without completing and submitting a CMIR, Congress should amend the Bank Secrecy Act to make such attempts to transport a violation of the Act. (See Appendix.)

• • •

11. Each of the foregoing recommendations addresses some feature of the current enforcement of the Bank Secrecy Act and related statutes and regulations. Each, if put into effect, can do much to enhance the capabilities of law enforcement agencies to cope with the increasingly sophisticated techniques of money launderers, without encroaching upon constitutionally guaranteed rights.

Yet these recommendations also have a common defect: neither individually nor collectively do they strike directly at the activities in which money launderers engage. One fact that is often overlooked in assessing the effectiveness of the Bank Secrecy Act is that while the Act has clearly enabled law enforcement agencies to detect money laundering activities more readily, it addresses the problem of money laundering indirectly by subjecting the money launderer to financial penalties or imprisonment only if he or she willfully violates the Act. As a result, the money launderer who complies with the recordkeeping and reporting requirements of the Act and the regulations by completing CTRs and other forms, as money launderers have frequently done in the past, can operate with virtual impunity, unless and until it can be proved that the launderer has violated another Federal statute.

The effects of money laundering, however, are too pernicious and too widespread to justify the belief that a highly limited scheme of Federal regulation, standing alone, will suffice to deal with the problem. The complex and sometimes ingenious techniques of professional money launderers make it possible for drug traffickers and other criminals to conduct illegal activities with substantial confidence that the profits from such activities can be safeguarded from detection and seizure by law enforcement agencies.

Moreover, money laundering invariably has a deleterious effect upon the financial community. By corrupting officials and employees of financial institutions in furtherance of laundering schemes, money launderers undermine the integrity of those institutions and, if discovered by law enforcement agencies, can vitiate the reputations of those institutions for soundness and prudent judgment. Even if a financial institution is unwittingly made a conduit for laundering, the mere fact that money launderers saw fit to use that institution may seriously affect the public's perception of the institution.

These facts clearly indicate that if financial institutions are to be adequately protected from abuse of their services by money launderers, and if law enforcement agencies are to deal more effectively with the problem of money laundering, the Federal Government must strike directly at the heart of the problem by making the use of financial institutions by money launderers a criminal offense.

Under the Commerce Clause of the United States Constitution, Congress clearly has the power to make the transmission of monetary instruments for purposes of money laundering a separate criminal offense. In *California Bankers Association* v. *Shultz*, which upheld the constitutionality of the Bank Secrecy Act, the United States Supreme Court stated:

> The plenary authority of Congress over both interstate and foreign commerce is not open to dispute, and that body was not limited to any one particular approach to effectuate its concern that negotiable instruments moving in the channels of that commerce were significantly aiding criminal enterprise. . . . Congress could have closed the channels of commerce entirely to negotiable instruments, had it thought that so drastic a solution were warranted; it could have made the transmission of the proceeds of any criminal activity by negotiable instruments in interstate or foreign commerce a separate criminal offense. (Emphasis supplied.)[45]

For these reasons, Congress should amend Title 18 of the United States Code to add a new section that would explicitly prohibit the conduct of transactions involving monetary instruments when the person conducting the transaction, or causing it to be conducted, intends to promote, manage, or otherwise further unlawful activities that typically are conducted by organized criminal groups, or knows that the monetary instruments represent income or proceeds from such activities. Such legislation would give Federal law enforcement agents clearly defined authority to investigate money laundering activities from the customer's side of the teller's window—to deal with money launderers and their couriers from the time they enter a financial institution.[46]

The Commission has prepared draft legislation that would address this issue, as well as an explanation of its principal provisions. (See Appendix.) This legislation, together with the preceding recommendations, should make it possible for the Federal Government to develop a fully coordinated national strategy to combat money laundering. If money laundering is the keystone of organized crime, these recommendations can provide the financial community and law enforcement authorities with the tools needed to dislodge that keystone, and thereby to cause irreparable damage to the operations of organized crime.

FEDERAL HOME LOAN BANK SYSTEM
OFFICE OF EDUCATION
1875 EYE STREET, NW, SUITE 1280
WASHINGTON, DC 20006
(202) 862-3600

Exhibit 5

TO: FHLB Presidents

DATE: February 21, 1986

FROM: Mary Jo Johnson, Training Coordinator
Bank System Office of Education

RE: Bank Secrecy Act Training

Enclosed for use by your staff is a video tape training program on Money Laundering and the Bank Secrecy Act. This training was developed in response to Congressional interest in the subject as well as the Chairman's and Director of OES' commitment to provide specific training to the staff in this area.

The total program is designed to last one half day or less. We suggest the person most expert in this area on your staff serve as the moderator for this training and be available to answer participant questions particularly concerning policy or procedural issues. The video portion is two hours in length and is comprised of three segments.

The first segment, entitled Money Laundering, was developed by the Office of Education and produced in cooperation with the FHLBB's Office of Communications and Office of Enforcement. Approximately 30 minutes in length, it consists of an introduction by Rosemary Stewart, Director of the Office of Enforcement, and other government agency officials, on how money is laundered. They discuss crime problems due to drug trafficking, how the problems are supported by money laundering, law enforcement efforts to stop such crimes, and the international currency flow from the proceeds of such criminal activities. This first segment concludes with an overview of examination policies and procedures.

The following segment is a one-hour panel discussion consisting of two Department of Justice officials and three commercial bank officials. The panel is moderated by an attorney from an independent law firm. While the discussion does not cover all the detailed requirements of the law, it does disclose some of the practical problems financial institutions may have to deal with in order to comply with the law. This segment assumes that the viewers are familiar with the law and implementing regulations.

The last segment begins with a relatively short statement by then acting Controller of the Currency, H. Joe Selby, as the spokesman for all federal financial institutions regulatory agencies. The remainder consists of two bank examiners discussing their examination findings of an institution's BSA regulatory violations and shortcomings prior to their forthcoming meeting with management of the bank.

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These last two segments were developed by the American Banker's Association (ABA) and were presented in the ABA's Bank Secrecy Act Video seminar that was held from September-November, 1985 throughout the country.

The training seminar should be presented to all personnel who have examination or supervisory responsibilities involving the Bank Secrecy Act sometime in the near future. The EOP section 129, Foreign Currency Transactions and Reporting Act, is included as a handout to be distributed to the participants for them to refer to during the video.

Also enclosed for your information are the names and phone numbers of government agency officials that were present at the ABA video seminar held in your particular area of the country. They may be available to answer questions for your staff or to participate in your training sessions depending on their individual schedules.

If you have any questions, feel free to call myself or Jane Johnson at (202) 862-3600.

Enclosures

cc: Chairman Gray
Julie Gould
Shannon Fairbanks
Supervisory Agent
Director of Examination
Training Administrator
Francis Passarelli, Director, OES
Eugene T. Byrne, Director
Chris Burdine, Assistant Director
BSOE Staff

EXHIBIT

FEDERAL HOME LOAN BANK BOARD
CRIMINAL REFERRAL FORM

INSTRUCTIONS

INTRODUCTION. The purpose of this form is to provide a consistent means by which financial institutions can make referrals of known or suspected criminal activity perpetrated against the institutions whether by insiders or those outside the institution. The form will provide an effective means by which appropriate law enforcement and supervisory authorities will be made aware of known or suspected criminal activity. Institutions should use care in filling out this form and should ensure that it is filled out in as complete a manner as practicable under the circumstances.

THE FOLLOWING INSTRUCTIONS SHOULD BE REFERRED TO WHEN FILLING OUT THE ITEMS REFERENCED:

ENTER ON PAGES 2 THROUGH 3, IN THE SPACE ALLOTTED AT THE TOP OF EACH PAGE, THE DOCKET NUMBER OF THE FINANCIAL INSTITUTION.

SECTION A - TO BE COMPLETED IN ALL REFERRAL CASES

ITEMS 1 THROUGH 3. Self explanatory

ITEM 4. Enter a check mark next to those descriptions in 4 which most generally describe the nature of the criminal activity. Use the list of criminal statutes provided on page 2 of the Instructions as an aid to filling out the applicable sections of Title 18.

ITEM 5. The term "confession" includes admissions made to the institution's personnel or to others.

ITEM 6. Provide a brief narrative description of the activity giving rise to the referral. Details will be provided later in the form in Section B. The purpose of this paragraph is to provide a summary description of the overall transaction.

ITEM 7. Complete subparagraphs (a) through (g) on each individual suspected of criminal activity. This list should include primary suspects only. Individuals who may have knowledge of the suspected criminal activity but who are not themselves suspected of being involved should be listed as witnesses under Item 4 of Section B. Provide any additional details known with respect to prior referrals or affiliations.

ITEMS 8 THROUGH 10. Self explanatory

SECTION B

This section should be completed in all cases where suspected criminal activity involves probable loss (before reimbursement or recovery) of $10,000 or greater or in all cases, regardless of amount, involving an affiliated person within the meaning of 12 C.F.R. §561.29.

ITEM 1. THIS PART OF THE REFERRAL IS CRITICAL. It should be as detailed as circumstances permit. The care with which this section is written may make the difference in whether the conduct and its possible criminal nature are clearly understood. The discussion points listed in this part are not exhaustive. They should be covered, but to the extent additional explanation would be useful as to any particular item or to the extent an additional category should be addressed, it should be done here. Feel free to use attachments or to continue the description on a separate sheet. Include any suggestions for the interviewing of any witnesses or the gathering of any documents or method of investigation which might prove useful in following up on the referral (e.g., tracing of proceeds).

ITEMS 2 THROUGH 7. Self explanatory

ADDITIONAL INSTRUCTIONS FOR EXAMINERS

Examiners should fill out this form whenever suspected criminal activity has been identified in an insured institution and either has not yet been reported by the institution or the referral made by the institution is deemed to be inadequate. It is important to note that this form should be filled out whenever criminal activity is suspected; examiners are not required to make any initial finding that such referrals would, if pursued, result in a criminal conviction. That judgment will be made by responsible law enforcement authorities. Any questions regarding whether or not any particular activity would constitute a crime for purposes of making a criminal referral should be resolved through communications with the Director of Examinations.

The purpose of this referral is to provide appropriate law enforcement authorities with complete and accurate information relating to suspected criminal activity. ALL information requested within the body of the form should be supplied at the time of the referral unless such information is not known or can only be supplied at a later date by operation of The Right to Financial Privacy Act. In the latter case, documents not provided with this form should be segregated and safeguarded in order that they might be subsequently supplied in accordance with the provisions of The Right to Financial Privacy Act. In filling out this form, examiners should avoid overly technical descriptions of transactions which might not be readily understood by law enforcement authorities unfamiliar with the operations of financial institutions.

DISTRIBUTION

ATTENTION: When making distribution, send the entire form (Sections A and B, when applicable) to each location, as instructed below.

IF REFERRAL IS MADE BY AN INSURED INSTITUTION

1. Retain one copy in the files
2. Send one copy to
   Director of Examinations,
   Federal Home Loan Bank
   for the District in which the institution is located
   (See Federal Home Loan Bank Address list below)
3. If Section B is required to be completed, send one copy
   to Director, Enforcement Division,
   Federal Home Loan Bank Board
   Washington, D.C. 20552
4. Send one copy to the appropriate local office of the FBI
5. Send one copy to the appropriate U.S. Attorney
   If also a criminal violation of state law, consider
   sending the referral to the appropriate
   state prosecuting authority

IF REFERRAL IS MADE BY FHLBANK EXAMINER/EMPLOYEE

Examiner

1. Retain one copy in the examination files under the name of the institution
2. Send four copies to the Director of Examinations

District Bank

3. Retain one copy in the District Bank under the name
   of the institution
4. If Section B is required to be completed, send one copy to
   Director, Enforcement Division,
   Federal Home Loan Bank Board
   Washington, D.C. 20552
5. Send one copy to the appropriate local office of the FBI
6. Send one copy to the appropriate U.S. Attorney. If also a criminal violation
   of state law, consider sending the referral to the appropriate
   state prosecuting authority

FEDERAL HOME LOAN BANK OFFICES

District 1
Federal Home Loan Bank of Boston
P.O. Box 9106 GMF
Boston, Massachusetts 02205

District 2
Federal Home Loan Bank of New York
One World Trade Center, Floor 103
New York, NY 10048

District 3
Federal Home Loan Bank of Pittsburgh
20 Stanwix Street
One Riverfront Center
Pittsburgh, Pennsylvania 15222-4893

District 4
Federal Home Loan Bank of Atlanta
P.O. Box 56527
Peachtree Center Station
Atlanta, Georgia 30343

District 5
Federal Home Loan Bank of Cincinnati
P.O. Box 598
Cincinnati, Ohio 45201

District 6
Federal Home Loan Bank of Indianapolis
P.O. Box 60
Indianapolis, Indiana 46206

District 7
Federal Home Loan Bank of Chicago
111 East Wacker Drive, Suite 800
Chicago, Illinois 60601

District 8
Federal Home Loan Bank of Des Moines
907 Walnut Street
Des Moines, Iowa 50309

District 9
Federal Home Loan Bank of Dallas
500 E. John Carpenter Freeway
P.O. Box 619026
Dallas/Fort Worth, Texas 75261-9026

District 10
Federal Home Loan Bank of Topeka
P.O. Box 176
Topeka, Kansas 66601

District 11
Federal Home Loan Bank of San Francisco
P.O. Box 7948
San Francisco, California 94120

District 12
Federal Home Loan Bank of Seattle
600 Stewart Street
Seattle, Washington 98101

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SUMMARY OF
CRIMINAL STATUTES

12 U.S.C. § 1725(g)	Falsely advertising (1) that one is insured by or affiliated with the FSLIC or (2) the extent or manner of FSLIC insurance
18 U.S.C. § 2	Aiding, abetting, counseling, commanding, inducing or procuring the commission of a federal offense
18 U.S.C. § 201	Bribery of public officials, including elected representatives, jurors and employees of any department or agency of the federal government, and witnesses in official proceedings; e.g., anyone who gives, offers or promises anything of value to a public official or a witness with the intent to influence that person's official functions
18 U.S.C. § 215	Kickbacks and bribes - makes it unlawful for any officer, director, employee, agent or attorney to solicit, accept or give anything of value in connection with any transaction or business of any financial institution
18 U.S.C. § 371	Conspiracy of two or more persons to either commit a federal offense or to defraud the United States (or any agency of the U.S.)
18 U.S.C. § 657	Theft, embezzlement or willful misapplication of an insured institution's funds by an officer, director, agent or employee with intent to defraud the institution.
18 U.S.C. § 1001	General false statements statute - knowingly and willfully falsifying or concealing a material fact or making a false statement or making or using false writing knowing it to be false
18 U.S.C. § 1006	False entries and reports or statements including material omissions, with intent to injure or defraud an insured institution or deceive a Federal Home Loan Bank examiner; receipt of any benefits by an officer, agent or employee of the institution from a transaction of the institution with intent to defraud by the individual.
18 U.S.C. § 1008	False statements made to induce FSLIC insurance of accounts, passing false documents in order to influence the FSLIC.
18 U.S.C. § 1009	Transmittal of untrue and derogatory statements concerning the financial condition of the FSLIC.
18 U.S.C. § 1014	False statement, oral or written (e.g., loan applications), made knowingly for the purpose of influencing the FHLBB or any institution whose deposits are federally insured upon any application, purchase agreement, commitment, loan (or any change or extension of same), including willfully overvaluing land, property or security.
18 U.S.C. § 1029	Credit card fraud - knowingly and with intent to defraud, producing, using or trafficking in counterfeit access devices.
18 U.S.C. § 1030	Computer fraud - knowingly accessing a computer without authorization or using it for unauthorized purposes, including obtaining information contained in records of financial institutions.
18 U.S.C. § 1306	Participation of an insured institution in lotteries or related activities.
18 U.S.C. § 1341	Mail fraud - scheme or artifice to defraud that makes use of the Postal Service.
18 U.S.C. § 1343	Wire fraud - scheme or artifice to defraud using transmission by wire, radio or TV for the purpose of carrying out the scheme.
18 U.S.C. § 1344	Bank fraud - scheme or artifice to defraud a federally insured institution or take money, funds, credit, assets, security or other property by misrepresentation.
18 U.S.C. § 1621	Perjury/false statements made under oath. (If false statement is not made under oath, individual may still be prosecuted under 18 U.S.C. § 1001 or 1014.)
18 U.S.C. § 1905	Disclosure of confidential information by a federal government employee.
18 U.S.C. § 1961	Racketeer Influenced and Corrupt Organizations ("RICO") statutes - investing in any enterprise affecting interstate commerce if the funds for the investment are derived from a pattern of racketeering activity. These activities include murder, drug dealing, bribery, robbery, extortion, counterfeiting, mail fraud, wire fraud, embezzlement from pension funds, obstruction of criminal investigation, fraud in the sale of securities, etc.
18 U.S.C. § 2113	Robbery of a savings and loan, bank or credit union and incidental crimes, including taking of any property in excess of $100 in value belonging to a savings and loan, bank or credit union and receiving, possessing, or disposing of same.
31 U.S.C. § 5311 31 C.F.R. § 103	Currency Transactions/Bank Secrecy Act.
15 U.S.C. § 78dd	Foreign Corrupt Practices Act of 1977 - Payment of anything of value to any foreign official, foreign political party or candidate or any other person where an American corporation knows or has reason to know the thing of value would be offered to a foreign official, foreign political party or candidate for foreign political office.
15 U.S.C. § 78ff	Criminal violations of securities laws.
15 U.S.C. § 78x	Criminal penalty provisions of securities laws.

OMB NO. [illegible]
Expires [illegible]

FEDERAL HOME LOAN BANK BOARD
CRIMINAL REFERRAL FORM

SECTION A
TO BE COMPLETED FOR ALL CRIMINAL REFERRALS

1. Name, Location and Docket Number of Financial Institution

Name ______

Location ______ Street ______ City ______ State ______ Zip

Docket Number ______ If activity occurred at branch office(s), please identify ______

2. Asset Size of Financial Institution *(millions of dollars)* ______

3. Approximate date and dollar amount (prior to any allowance for restitution or recovery) of suspected violation

Date ______ Month Day Year Amount *(thousands of dollars)* ______

4. Summary characterization of the suspected violation. Check appropriate box(es)

☐ Defalcation/Embezzlement
☐ False Statement/Fraud
☐ Check Kiting
☐ Bribery/Gratuity
☐ Misuse of Position or Self Dealing
☐ Unexplained Loss
☐ Other (Describe) ______

Applicable Section(s) of Title 18, U.S. Code (if known)
(see list on page 2 of Instructions) ______

5. Has there been a confession? ☐ Yes ☐ No If so, by whom? ______

6. Explanation/Description of Suspected Violation (Give a brief summary of the suspected violation, explaining what is unusual or irregular about the transaction.) (If necessary, use Continuation Sheet.)

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FEDERAL HOME LOAN BANK BOARD
CRIMINAL REFERRAL FORM

FHLBB DOCKET NUMBER OF THE FINANCIAL INSTITUTION ____

SECTION A - CONTINUED
TO BE COMPLETED FOR ALL REFERRAL CASES

7. Person(s) Suspected of Criminal Violation (If more than one, use Continuation Sheet.)

a. Name ____ First ____ Middle ____ Last

b. Address ____ Street ____ City ____ State ____ Zip

c. Date of Birth (if known) ____ Month Day Year   Social Security Number (if known) ____

d. Relationship to the financial institution. Check all applicable box(es)

☐ Officer
☐ Director
☐ Employee
☐ Agent
☐ Broker
☐ Borrower
☐ Shareholder
☐ Savings Customer
☐ Other, Specify ____

e. Is person still affiliated with the financial institution? ☐ Yes ☐ No
If no, ☐ Terminated ☐ Resigned   Date ____ Month Day Year

If no, describe circumstances. (If necessary, use Continuation Sheet.) ____

f. Prior or related referrals? ☐ Yes ☐ No   If yes, please identify ____

g. Is person affiliated with any other financial institution? ☐ Yes ☐ No
or business enterprise? ☐ Yes ☐ No   If yes to either or both, please identify ____

8. This matter is being referred to the FBI in ____ City ____ State

and the U.S. Attorney in ____ City ____ State ____ Judicial District (if known)

9. Offer of Assistance
The individuals listed below are/will be authorized to discuss this referral with FBI and Department of Justice officials and to assist in locating or explaining any documents pertinent to this referral, **provided that contact is first made with**

Name ____   Position ____
Phone No. ____

Authorized Individuals
Name ____   Phone No. ____
Name ____   Phone No. ____
Name ____   Phone No. ____

10. Form Prepared By ____
Position ____
Agency/Institution ____
Phone No. ____   Date ____ Month Day Year

ATTENTION

COMPLETE SECTION B OF FHLBB FORM 366 AND SUBMIT WITH THIS SECTION IN ALL CASES WHERE SUSPECTED CRIMINAL ACTIVITY INVOLVES PROBABLE LOSS (BEFORE REIMBURSEMENT OR RECOVERY) OF $10,000 AND GREATER OR IN ALL CASES, REGARDLESS OF AMOUNT, INVOLVING AN AFFILIATED PERSON WITHIN THE MEANING OF 12 C.F.R. § 561.29.

FEDERAL HOME LOAN BANK BOARD
CRIMINAL REFERRAL FORM

FHLBB DOCKET NUMBER OF
THE FINANCIAL INSTITUTION ____________

SECTION B

TO BE COMPLETED IN REFERRAL CASES WHERE SUSPECTED CRIMINAL ACTIVITY INVOLVES PROBABLE LOSS (BEFORE REIMBURSEMENT OR RECOVERY) OF $10,000 OR GREATER OR IN ALL CASES, REGARDLESS OF AMOUNT, INVOLVING AN AFFILIATED PERSON WITHIN THE MEANING OF 12 C.F.R. § 561.29.

1. Give a chronological and complete account of the suspected violation. (If necessary, use Continuation Sheet.)
   - Relate key events to documents and attach copies of those documents.
   - Explain who benefited, financially or otherwise, from the transaction, how much and how.
   - Furnish any explanation of the transaction provided by the suspect and indicate to whom and when it was given.
   - Furnish any explanation of the transaction provided by any other person.
   - Furnish any evidence of cover-up by the suspect or evidence of an attempt to deceive federal or state examiners or others.
   - Indicate where the suspected violation took place (e.g., main office, branch, other).
   - Recommend any further investigation that might assist law enforcement authorities in fully examining the potential violation.

2. Indicate whether the suspected violation appears to be an isolated incident or whether it relates to other transactions. (Explain)

3. Exclusion of Information from the Referral
   Has any pertinent information been excluded from this referral as a result of any legal or other restraint? ☐ Yes ☐ No If yes, why? ____________

   Have the excluded information or documents been segregated for later retrieval? ☐ Yes ☐ No

FEDERAL HOME LOAN BANK BOARD
CRIMINAL REFERRAL FORM

FHLBB DOCKET NUMBER OF
THE FINANCIAL INSTITUTION ________

SECTION B

TO BE COMPLETED IN REFERRAL CASES WHERE SUSPECTED CRIMINAL ACTIVITY INVOLVES PROBABLE LOSS (BEFORE REIMBURSEMENT OR RECOVERY) OF $10,000 OR GREATER OR IN ALL CASES, REGARDLESS OF AMOUNT, INVOLVING AN AFFILIATED PERSON WITHIN THE MEANING OF 12 C.F.R. § 561.29.

4. **Witnesses**
List any witnesses who might have information about the suspected violation and describe their position or employment. Indicate whether they have been interviewed. (If necessary, use Continuation Sheet.)

	Name	Position	Address	Phone No.	Interviewed? Yes	Interviewed? No
a.					☐	☐
b.					☐	☐
c.					☐	☐
d.					☐	☐
e.					☐	☐

5. **Discovery and Reporting**
a. Who discovered the suspected violation and when? ________

b. Has the suspected violation been reported to the Board of Directors? ☐ Yes ☐ No
By whom and when? ________

c. Has the Board of Directors taken action? ☐ Yes ☐ No If so, what and when?

d. Has the suspected violation previously been reported to federal or local law enforcement authorities or to any federal or state supervisory agency? ☐ Yes ☐ No If so, by whom, to whom, and when?

6 Loss a. Amount of loss known		$	f. Name of surety bond company
b Restitution by :	$		
________	$		g. Amount of bond $
			h. Amount of deductible $
c. Settlement by surety company	$		i. Was claim filed? ☐ Yes ☐ No if yes, when
d. Total restitution and settlement to date		$	
e Total loss to date		$	j. Is additional loss suspected? ☐ Yes ☐ No (If yes, explain in Item 1, Section B.)

7. Has the suspected violation had a material impact on or otherwise affected the financial soundness of the institution? ☐ Yes ☐ No If yes, please explain.

CONTINUATION SHEET

FHLBB DOCKET NUMBER OF
THE FINANCIAL INSTITUTION ________

ITEM NO	REMARKS

FHLBB FORM [illegible]
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Folder - Form 366
(mailed 100 to each field
9-13-85)

Exhibit 7

Federal Home Loan Bank Board **Memo**

OFFICE OF GENERAL COUNSEL

INTER-OFFICE COMMUNICATION

R.S.

FROM: Rosemary Stewart
Director, Enforcement Division, OGC

DATE: September 11, 1985

TO: Principal Supervisory Agents
Acting Director, OES
Deputy Directors and Assistant
Directors, OES
Directors of Examination, FHLBanks

SUBJECT: New Criminal Referral Form and Process

Attached please find a copy the newly revised criminal referral form prepared in cooperation with the Department of Justice and the federal banking agencies, and recently approved by the Office of Management and Budget for our immediate use. This same form (with only minor changes for each agency) also will be used by the banking agencies for making criminal referrals, and eventually by all insured banks and savings and loan associations. The form is more lengthy than our prior version in response to specific recommendations from the Justice Department about what U.S. Attorneys and the FBI need, to initiate and pursue criminal investigations. You will note however, that there is a short version of the form for less serious offenses (such as teller defalcations) involving less than $10,000 in loss and not involving directors, officers or other affiliated persons.

Pursuant to the Bank Board's proposed regulation published on June 10, 1985, all FSLIC-insured institutions will be required to file their own criminal referrals when the regulation is finalized (which we expect sometime in October). The new form is designed for use by institutions as well as by Board examiners, attorneys, and other Board representatives. By making it the duty of institutions to file these reports, the regulation should greatly decrease the burden on the FHLBanks' examiners of preparing referrals. Examiners will be preparing them only in cases where the institution fails to file a referral or when the examiner feels that an inadequate referral has been made by the institution. Because copies of all forms filed by institutions will be provided to the Directors of Examinations, the examiners may review the adequacy of an institution's criminal referrals as they are made without awaiting the next examination of the

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institution. (The review of such referrals also may provide information that the examiners wish to investigate between examinations.)

The procedures for completing the referrals and the recipients of copies of the referrals also have changed, and are set forth in the Instructions for completion of the form on page 1. Preparers of the form should review these instructions carefully.

Another important change in the form in the absence of any reference to Right to Financial Privacy Act ("RFPA") notices. This is because the Justice Department has requested that we make our referrals in a manner that does not require notices to customers protected under the RFPA. This means that the identification of customers (or account numbers of customers) who are protected by the RFPA shall not be included in referrals sent by Bank Board representatives. This will necessitate our removal of such names and account numbers from referrals. Thereafter, the Justice Department will present us with Grand Jury subpoenas, which are exempt from the notice requirements of the RFPA, to obtain our complete records about the conduct described in the referral. The Directors of Examination previously have been provided with guidelines about the RFPA and when it requires notice to customers. These same guidelines now may be used to determine what identifying information should be deleted from our referrals made on the new referral form.

The new form is being printed at this time and a supply of the printed copies should be circulated to each FHLBank next week. As noted above, insured institutions will not be required to make criminal referrals on the form until the Board's regulation becomes final, although they may do so prior to that time if they wish. Accordingly, the FHLBanks are encouraged to distribute the form to all insured institutions as soon as practical. Examiners should begin use of the form immediately.

If you have any questions about the form or the new procedures for making criminal referrals, please do not hesitate to call me at (202) 377-6437 or Enforcement Attorney John Downing at (202) 377-6434.

cc: Norman H. Raiden
Ralph W. Christy

To All Ef. Attys
+ Nancy P Richard
+ N. Raiden
R. Christy
T. Long

ent of Justice

QRS

Copy to [illegible] [illegible]
ment A

Exhibit 3

QRS
4/1/85

FOR IMMEDIATE RELEASE
TUESDAY, APRIL 2, 1985

CRM
(202) 633-2010

Attorney General Edwin Meese III today announced the signing of an agreement between the Department of Justice, the Federal Bureau of Investigation and the four federal banking regulatory agencies designed to improve the detection, investigation, and prosecution of bank fraud cases, particularly those involving criminal misconduct on the part of bank officers.

Signers of the agreement were:

- Attorney General Meese;
- William H. Webster, Director of the FBI;
- C. T. Conover, Comptroller of the Currency;
- Edwin J. Gray, Chairman, Federal Home Loan Bank Board (FHLBB);
- Preston Martin, Vice-Chairman of the Federal Reserve Board, and
- Margaret L. Egginton, Deputy to the Chairmen of the Federal Deposit Insurance Corporation (FDIC).

"The health of the nation's banking industry is essential to the health of the nation's economy," Meese said.

"Bank fraud perpetrated by insiders, even directed toward relatively small banks, seriously undermines the confidence and trust that individuals and businesses place in the banking industry as a whole," he said.

"That confidence and trust will diminish all the more if the public fails to perceive a comprehensive and active law enforcement presence in the industry. And interagency cooperation is vital to that lawful presence."

In 1984, the Attorney General said, there were 79 bank failures and 27 failures of savings and loans, an unprecedented number since the beginning of federal controls in the 1930's. In 1983, there were 48 bank failures and 46 failures of savings and loans.

The Justice Department survey of 75 FDIC-insured banks that failed from January 1, 1980, to June 17, 1983, found that 61 percent of such failures involved actual or probable criminal misconduct by bank insiders.

"By its own estimate, the FDIC has told Congress that criminal misconduct by insiders was a major contributing factor in 45 percent of the same 75 bank failures," Meese said.

Then-Attorney General William French Smith invited heads of the concerned agencies last year to meet and recommend improvements in the federal bank fraud enforcement effort. Such a meeting had been recommended by the Economic Crime Council, which had made bank fraud prosecutions one of its highest priorities.

Beginning December 19, 1984, a working group representing the agency heads met nine times and addressed such issues as:

-- Procedure and content of criminal referrals;

-- Special handling of highly significant cases;

-- Bank fraud training for examiners, agents and prosecutors;

-- Information sharing and a joint strategy in dealing with the Right to Financial Privacy Act, which tends to restrict the interagency flow of information;

-- Case tracking mechanisms, and

-- Development of more effective interagency cooperation.

As a result of these meetings, the working group drafted the document signed today, which contains more than 20 points of agreement. These points embody proposals designed to overhaul and improve the federal law enforcement response to bank fraud cases.

A principal objective of the working group has been to design uniform referral procedures both for routine and significant cases, the Attorney General said.

One feature has been the preparation of a standard referral form, to be used by all four agencies, designed to elicit the type of information deemed most important to the FBI and the Department of Justice in assessing the prosecutive merit of the suspected violations. It comes in both a long- and short-form version and places greater emphasis on major cases, particularly ones involving criminal misconduct by bank officers.

The agreement emphasizes that in significant cases the written referral should be supplemented by oral presentations and follow-up, all of which helps the bank regulatory agency to communicate with the U. S. Attorney and furnish assistance when needed.

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The agreement also establishes mechanisms for ensuring that interagency liaison and communication is effective at the regional and district levels and among the Working Group members in Washington.

Each of the agencies participating in the working group currently operates under legal or procedural restrictions that limit or impede access to one another's records. Some are statutory, such as the Right to Financial Privacy Act and the rule of grand jury secrecy as provided in Rule 6 of the Federal Rules of Criminal Procedure. With respect to these restrictions, the working group is supporting legislative amendments exempting certain interagency communications.

The agreement provides as well that the Fraud Section of the Justice Department's Criminal Division will modify its existing computerized Fraud and Corruption Tracking System (FACT) to include bank fraud cases of particular significance to the Working Group.

Meese said this should help the working group agencies to measure the prosecutive response nationwide and to recommend assistance in those areas of the country where prosecutions are failing to keep up with apparent violations. The agreement also provides for interagency use, in appropriate circumstances, of the FBI's computerized indices known as the Field Office Information Management Systems (FOIMS).

The agreement also recognizes the need for increased, as well as coordinated, training for prosecutors, FBI agents and bank examiners. For example, the FBI has agreed to make space available to bank examiners in its "Bank Failure-In-Service" course presented at the FBI Academy in Quantico, Virginia, and the Department will add a bank fraud institute to its Advocacy Institute Program.

Meese said the working group has had productive results and will continue its periodic meetings, not only to monitor and implement the points of agreement, but also to monitor constantly the entire bank fraud area.

# # # #

Agreements And Recommendations
# of the
Attorney General's Bank Fraud Working Group

Edwin Meese III
Attorney General

April 2, 1985

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AGREEMENTS AND RECOMMENDATIONS OF THE JUSTICE DEPARTMENT - SUPERVISORY AGENCIES WORKING GROUP

This document embodies the areas of agreement and recommendations of the Working Group created in December, 1984, to address problems and promote cooperation toward the goal of improving the federal government's response to white-collar crime in the nation's federally-regulated financial institutions. The Working Group is composed of senior officials of the U.S. Department of Justice Criminal Division, the Federal Bureau of Investigation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board. The four named regulators of financial institutions are referred to herein as the "Supervisory Agencies."

After an initial meeting between the Attorney General and other Justice Department officials and the heads of the Supervisory Agencies, an agenda was established and the Working Group was formed to address the matters contained herein. This document represents the results of concerted effort by the Working Group to tackle and resolve issues of major significance relating to the detection, reporting and prosecution of bank-related crimes.

The Working Group has focused particularly on white-collar crimes by "insiders" of financial institutions, which have plagued a large number of institutions with resulting large losses to the FDIC and FSLIC insurance funds. In response, the Working Group has improved the entire referral system for suspected bank fraud and abuse, developed avenues for better communications, coordination, and tracking, established new training opportunities, and determined to support certain legislative proposals as set out herein. With improved cooperation overall, the Supervisory Agencies and the Justice Department will be better equipped to respond more effectively to criminal conduct involving the nation's financial institutions. Following this document is a separate summary that elaborates upon certain of the agreements and recommendations contained herein.

The Criminal Referral Process

1. The Working Group recognizes the pivotal role of the referral process in ensuring an effective law enforcement response to crimes involving financial institutions. As envisioned by the Group and set out herein, the referral process is more than simple notification; it is a procedure for notification and continuing interest and coordination in which the Justice Department enlists the help of the Supervisory Agencies to detect and understand suspected crimes, and the Supervisory Agencies regard effective criminal law enforcement as one arm of their own enforcement efforts. This process will be sustained by regular personal

contact between the parties hereto at both the national and local levels, and by a sustained interest in and attention to each other's needs.

2. The Working Group endorses the use of a uniform method for reporting suspected criminal conduct to the U.S. Department of Justice (hereafter "Justice Department" with the understanding that, unless specified otherwise, the term refers to the Department's Headquarters in Washington, D.C., the applicable U.S. Attorneys and the FBI - both Headquarters and District offices.) The Working Group has developed a uniform referral form for this purpose to be used by the Supervisory Agencies and by their regulated financial institutions. The purpose of the referral form is to promote the transfer of complete and accurate information on key points deemed most important by the Justice Department for its assessment and evaluation of possible criminal cases. In connection with the referral form, the following matters also have been agreed upon:

a. The proposed referral form has been designed so that possible crimes involving losses of less than $10,000 and not involving "insiders" may be reported on a "short-form" portion of the referral form so that the numerous cases of teller defalcations involving small amounts of loss can be reported with minimal burden to the preparer.

b. The proposed referral form will be adapted to each Supervisory Agency's particular procedures, and the Agencies will strive to assure uniformity in the form and its instructions in all substantial respects.

c. The Working Group members will work together in an effort to obtain OMB and other required clearances for the referral form's use.

d. The Supervisory Agencies will strive to implement a regulation or other formal policy that requires their regulated financial institutions to make criminal referrals in all cases directly to the appropriate criminal authorities, with copies to their principal Supervisory Agency. ✓

e. The Working Group will be responsible for monitoring each Agency's completion and adoption of the referral form, the referral regulation or policy statement, necessary approvals, and implementation of the form's use, with the goal of having the referral form in use by each of the Supervisory Agencies as soon as practicable.

3. The Supervisory Agencies will establish procedures to review the criminal referrals made by their regulatees and will make referrals directly where (a) the referral made by the financial institution is deemed inadequate, or (b) the suspected criminal conduct discovered by the Supervisory Agencies has not been reported by the regulatee(s).

4. The existence of the referral form shall not prevent a Supervisory Agency from making a more detailed written referral, and shall not prevent referrals by telephone or personal contact in situations where immediate contact of the Justice Department is advisable.

5. When referrals are made by the Supervisory Agencies, they shall be made at an early stage, that is, when the Agencies' representatives first obtain evidence to support a belief

that a crime has been or may have been committed, with allowances for reasonable periods of time for review of the proposed referral under each Agency's established procedures. The referral of suspected criminal conduct shall in no way restrict the Supervisory Agencies from continuing their own examinations or investigations into the same conduct in order to carry out their regulatory responsibilities, unless they are requested to cease or suspend such activity by Justice Department representatives in connection with an ongoing criminal investigation or prosecution.

6. Following the dispatch of a criminal referral by a Supervisory Agency, that Agency shall segregate the documents and information relative to the referral or establish procedures to ensure that such documents and information are readily retrievable if the Agency is requested to produce them by the Justice Department.

7. Copies of the following types of referrals shall be forwarded to the Fraud Section of the Justice Department's Criminal Division and to the FBI Headquarters in Washington, D.C. by the Supervisory Agencies: referrals involving losses above an agreed upon amount, referrals disclosing possible crimes of particular significance to the Agencies (including criminal misconduct by "insiders" of financial institutions) or that otherwise are of national impact, and referrals that involve significant criminal conduct in more than one jurisdiction.

8. In connection with significant cases as described in the preceding paragraph, the Supervisory Agencies are encouraged to seek the active assistance of the Fraud Section. Such assistance

should be sought, to the extent practical, at the time of or, in appropriate cases, in advance of the Agencies' referrals to the U.S. Attorneys. The Fraud Section and FBI Headquarters will assist the U.S. Attorneys in their evaluation, investigation, and/or prosecution of such significant cases, and where appropriate, will coordinate multi-jurisdictional cases. In appropriate cases, the Fraud Section also will supply prosecutorial staffing.

9. The Supervisory Agencies will strive to communicate directly with the U.S. Attorneys' offices about significant criminal referrals involving their regulated financial institutions. It is understood that oral and written communications follow-up, and coordination are encouraged between the local offices of the Supervisory Agencies and the U.S. Attorneys' and local FBI offices. These parties shall communicate their concerns about particular cases and engage in dialogue to resolve problems. Thereafter, the Justice Department Fraud Section will entertain inquiries, complaints, and "appeals" of declinations by U.S. Attorneys with respect to referrals made by the Supervisory Agencies or their regulated financial institutions on cases believed by the Agencies to be significant.

Coordination, Cooperation and Information-Sharing Between the Working Group Representatives

10. Each of the Working Group members has exchanged information that identifies appropriate points of contact (by name, address and telephone number) for making criminal referrals, for seeking assistance with investigations, and for resolving any problems with coordination. The Justice Department also has identified

individuals in U.S. Attorneys' offices and FBI field offices who are experienced in financial institutions crimes. All Working Group members are responsible for keeping the "contact lists" updated on a reasonably current basis.

11. The Working Group members will actively encourage periodic meetings between representatives of their regional or district offices. For example, the regional management of the Supervisory Agencies are encouraged to get acquainted and maintain contact with the U.S. Attorneys and FBI managers for their region, and to explore whether there are any problems in communications or coordination that can be resolved at that level.

12. The Supervisory Agencies will review current regulations, delegations, and procedures to determine if changes are required to assure expeditious responses to requests by the Justice Department for written materials or for direct assistance by representatives of the Supervisory Agencies. If needed, appropriate changes will be made to such regulations, delegations and procedures.

13. The Working Group members will cooperate fully in the sharing of relevant information, subject only to applicable legal restrictions, and will assist one another in assuring that information so shared may be used by the recipient(s) in appropriate criminal, civil or administrative proceedings.

14. The Justice Department will implement procedures to improve its reporting of information to the Supervisory Agencies. In particular, it is agreed:

a. The disposition of criminal referrals sent to the Justice Department pursuant to paragraph 6 above, shall be reported by the Justice Department to the appropriate Supervisory Agency that forwarded the referral. In addition, U.S. Attorneys will be instructed to notify the referring Supervisory Agency of the disposition of referrals made by such Agency.

b. The Justice Department will instruct the U.S. Attorneys to notify the appropriate Supervisory Agency when indictments and convictions are returned against "insiders" or employees of financial institutions, particularly when such individuals continue to be affiliated with the financial institutions at the time of the indictments or convictions.

c. Information obtained by the Justice Department during criminal investigations will be shared with the appropriate Supervisory Agencies where such information may assist the Agencies in carrying out their regulatory responsibilities, subject only to applicable legal restrictions or where confidentiality is essential to maintain the integrity of a criminal investigation.

15. In order to assist the Justice Department in its execution of the information-sharing described in the preceding paragraph, the Working Group supports an amendment to Rule 6(e) (Fed. R. Crim. P. 6(e)), which would permit the Justice Department to petition the appropriate Court for permission to make available to the appropriate Supervisory Agency(ies) information obtained pursuant to the Grand Jury process that would assist the Agencies in carrying out their regulatory responsibilities.

Tracking of Criminal Referrals and Investigations and Information Systems

16. The Justice Department Fraud Section will develop a tracking system to monitor significant criminal referrals and investigations involving federally regulated financial institutions:

a. This tracking system will be initiated by inputting those referrals of which copies have been sent directly to the Fraud Section pursuant to Paragraph 7 above.

b. Information from the Fraud Section's tracking system will be shared with the Supervisory Agencies, subject only to applicable legal restrictions.

17. The FBI will input all of the Supervisory Agencies' and regulated financial institutions' criminal referrals on its FOIMS computer system. Consistent with applicable legal restrictions and the need to maintain confidentiality concerning certain ongoing criminal investigations, the FBI will share information from the FOIMS system with the Supervisory Agencies.

18. Pursuant to previous agreements between the Supervisory Agencies, criminal referrals and other information about individuals are being shared by and among the Supervisory Agencies. The Agencies have agreed to coordinate this process in connection with their respective processes of computerization of information and to make such information available to one another and to Justice Department representatives upon request, subject only to applicable legal restrictions.

Training

19. The Working Group agrees to coordinate and share training courses and other training resources in the area of white-collar crimes involving financial institutions. In particular:

a. The FBI has agreed to make at least 30 slots available for training examiners or other employees of the Supervisory Agencies in a special "Bank Failure In-Service" course, which will be presented in Quantico, Virginia, during July 1985. The FBI also will present regional training programs in which the Supervisory Agencies will participate in 1986. All such training by the FBI will focus on investigative techniques and problems in cases involving financial institutions.

b. The Supervisory Agencies will explore with the Federal Financial Institutions Examination Council ("FFIEC") whether it will assume responsibility for presenting a white collar crime course in a form similar to that currently presented by the Office of the Comptroller of the Currency ("OCC"). The Working Group members will encourage the FFIEC to present such a training course, which will be available to representatives of the Supervisory Agencies and the Justice Department.

c. While the FFIEC is considering the establishment of the white collar crime course, and/or in the event that such a course is not established by the FFIEC, the OCC will continue to make slots available to the other Supervisory Agencies and the Justice Department in its "White Collar Crime Seminar" given periodically during each year.

d. The Justice Department will develop a training course (or a segment of a course) for Assistant U.S. Attorneys that focuses on the investigation and prosecution of white collar crime involving federally-regulated financial institutions, and will strive to make slots available to the Supervisory Agencies for appropriate representatives to attend.

The Right to Financial Privacy Act

20. The Working Group has agreed to support a clarifying legislative amendment to the Right to Financial Privacy Act of 1978 ("RFPA") (12 U.S.C. § 3401 et seq.) relative to transferring information to law enforcement authorities. The amendment endorsed by the Working Group is one that would permit the transfer of financial information lawfully in the possession of one government authority (such as a Supervisory Agency) to another government authority (such as the Justice Department) for a law enforcement purpose within the jurisdiction of the receiving authority, without notice to the customer.

21. The Justice Department has found that the RFPA notices to customers can be damaging to the conduct of criminal investigations. Therefore, until a clarifying amendment is enacted the Supervisory Agencies will implement procedures to ensure that criminal referrals are made in a manner that does not require notices to customers. Accordingly, it is anticipated that, in some instances, referrals may omit the names of significant suspects or

witnesses and/or copies of supporting documentation from protected customers' records. In such cases the Justice Department will utilize Grand Jury subpoenas to compel production of the omitted information from the Supervisory Agencies or directly from their regulated financial institutions.

22. The Working Group will, by written request to the Justice Department, seek a clarification of the May 22, 1979, opinion to Deputy Attorney General Civiletti from the Office of Legal Counsel relative to criminal referrals by the Supervisory Agencies and the requirements of the RFPA concerning customer notices in connection with such referrals.

The Bank Bribery Act

23. The Working Group has addressed numerous questions and concerns relating to the Bank Bribery Act. Pub. L. No. 98-473, § 1107, 98 Stat. 2145 (1984), 18 U.S.C. § 215. In particular, the Group is exploring the possibility of clarifying the scope of the Act by regulations or policy statements issued by the Supervisory Agencies and/or by written guidance from the Justice Department. These matters will continue to be pursued by the Working Group.

Continuation of the Working Group

24. The Working Group unanimously agrees that the communications and cooperation initiated by the Group have been positive and productive. Accordingly, the Working Group will continue to meet on a regular basis to discuss implementation of and any problems related to the matters set out herein and to share

information about specific criminal cases and other matters that may be of interest to all members of the Working Group.

Dated:

U.S. Department of Justice	Federal Bureau of Investigation
By: ______________________	By: ______________________
Board of Governors of the Federal Reserve System	Office of the Comptroller of the Currency
By: ______________________	By: ______________________
Federal Deposit Insurance Corporation	Federal Home Loan Bank Board
By: ______________________	By: ______________________

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SUMMARY OF THE RATIONALE FOR CERTAIN OF THE MATTERS SET FORTH IN THE ATTACHED AGREEMENTS AND RECOMMENDATIONS OF THE JUSTICE DEPARTMENT-SUPERVISORY AGENCIES WORKING GROUP

Each of the numbered paragraphs in the attached "Agreements and Recommendations of the Justice Department-Supervisory Agencies Working Group" represents the results of lengthy discussion and consideration by the Group. This summary does not attempt to discuss all of the reasons for the many agreements and understandings that have been reached, but only to expand upon the rationale for certain of the more significant provisions.

The Criminal Referral Process

Paragraphs 1 through 6 of the Working Group Agreements set forth procedures for the use of a uniform criminal referral form by all of the Supervisory Agencies and by the financial institutions regulated by them. The proposed form itself is the product of considerable effort by the Working Group and is designed to relay the type of information deemed most important by the Justice Department for its assessment and investigation of matters referred by the Supervisory Agencies and their regulated financial institutions. The form and its detailed instructions will assure that such referrals are an effective means of notifying criminal law enforcement authorities of suspected offenses. In particular, a referral made by use of the form will identify the suspected criminal violation both in summary and in detailed form by instructing the preparer to give a chronological and complete

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account of the suspected violations by relating key events and identifying significant documents and potential witnesses.

While the proposed referral form requests considerably more information than often has been provided in the past by the Supervisory Agencies and their regulated financial institutions, it is not intended to delay the referral process while all answers to the questions are gathered. (See Paragraph 5.) In fact, if certain information is not readily available to the preparer, he/she will be instructed to complete the known information and not delay the transmittal of the form. Moreover, the Working Group has designed a referral form that has a "short form" version for referrals that disclose suspected losses under $10,000 that do not involve "insiders". In terms of the volume of referrals received at this time by the Justice Department, such "smaller" crimes represent the overwhelming majority of cases reported. The "long form" version of the referral form will be utilized for all other criminal referrals by the Supervisory Agencies and their regulated financial institutions. (Paragraph 2(a).)

It is recognized that the actual approval of the form by each of the Supervisory Agencies and clearance for its use by OMB will take some time. The Working Group has agreed to cooperate fully in achieving use of the form in a substantially identical format. (Paragraph 2(b), (c), and (e).) Also key to the new referral process will be the implementation of regulations or other formal requirements by each of the Supervisory Agencies that require referrals to be made directly by their regulated financial institutions (Paragraph 2(d)). Only if the referrals made by the financial institutions are inadequate or if a referral has not been made by an institution, will the Supervisory Agencies make the referral directly (Paragraph 3), its being understood that the Supervisory Agencies will promptly undertake to make referrals themselves in both circumstances, and will not rely on the institutions to do so unless the Agencies are assured that the institutions have made the referrals in a satisfactory manner. This procedure was adopted in the interest of administrative economy by the Supervisory Agencies, who believe that their limited resources will better be spent preparing the limited number of referrals on such matters as serious abuse by "insiders" of financial institutions, which referrals are unlikely to be made by the institutions themselves.

The Working Group stresses that the existence of the referral form is not intended to prevent referrals by telephone or personal contact in emergency cases or any situation where the Agency believes that evidence or witnesses could disappear if there are delays in making the referral. (Paragraph 4.) Similarly, the form is not intended to deter the preparation of more detailed referrals as deemed appropriate by the Supervisory Agencies. (Paragraph 4.)

The Working Group considered whether to identify an evidentiary standard for when criminal referrals are to be made, such as when "substantial evidence" of a crime has been discovered, but determined not to do so. Often the preparers of criminal referrals are not in a position to make such determinations, particularly when the suspected crime requires evidence of "willfulness" or an "intent to defraud." These are decisions to be made by Justice Department representatives, who prefer to be advised of the potential crime early when it is first suspected by the Supervisory Agencies so that Justice may develop the facts toward evaluation of a criminal prosecution. Accordingly, Paragraph 5 of the Working Group's Agreements provides that referrals of suspected criminal violations shall be made at an early stage when the Supervisory Agencies first obtain evidence to support a belief that a crime has been or may have been committed.

Of particular note is the role that the Fraud Section of the Justice Department's Criminal Division has agreed to assume in the criminal referral process. (Paragraphs 7 through 9.) The Fraud Section will assist in the Department's consideration and coordination of significant referrals (Paragraph 8), and will entertain inquiries, complaints, and "appeals" by the Supervisory Agencies concerning referrals made to U.S. Attorneys' offices (Paragraph 9).

Coordination, Cooperation and Information-Sharing

Paragraphs 10 through 15 detail areas in which the Working Group has established points of contact (Paragraph 10), encouraged communications at the regional level (Paragraph 11), and agreed to improve their responsiveness to requests for information from one another (Paragraphs 12-15.) Each of the Working Group members currently has legal or procedural restrictions that limit or impede access to one another's records.

Certain of these restrictions are statutory, such as the Right to Financial Privacy Act and Grand Jury Rule 6(e), in response to which the Working Group are supporting legislative amendments. (See Paragraphs 15 and 20.) The Working Group members will assure that any other impediments are only those actually required by law or regulation or necessary to preserve the integrity of information or investigations.

The proposed amendment to Rule 6(e) set out in Paragraph 15 would allow Justice Department representatives to petition the appropriate Court to permit the sharing of information obtained pursuant to the Grand Jury process, with the Supervisory Agencies. Often the receipt of grand jury information could facilitate the Supervisory Agencies' taking administrative or judicial action to prevent harm to financial institutions under their supervision, and/or to prevent or reduce losses to the FDIC or FSLIC insurance funds. This is particularly significant because the Justice Department may be unable to use grand jury information because it does not meet the higher standards required for criminal prosecutions or because the demands of more serious criminal cases postpone action on crimes involving financial institutions. The same information however, could be significant to a Supervisory Agency either to support civil action or to initiate its own examination or investigation of the matter.

Tracking and Information Systems Regarding Criminal Referrals and Investigations

Paragraphs 16 through 18 recite the agreements reached relative to tracking and information systems maintained about the individuals named in criminal referrals. As a result of the agreements reached in this area, all of the Working Group members will have access to valuable information in connection with carrying out their respective responsibilities. For example, the Justice Department now may be able to determine if a suspect referred by one Supervisory Agency also has been referred for a similar crime by another Supervisory Agency in another jurisdiction. (Paragraphs 16-17.) Moreover, a Supervisory Agency may be able to access material information from the Justice Department about individuals filing change in control applications with the Agency. (Paragraphs 14(c), 16 and 17.)

Training

The Working Group has agreed to coordinate and share training courses and other training resources in the area of white collar crimes involving financial institutions. In particular, the FBI already has agreed to present special training for examiners from the Supervisory Agencies, and other courses to be made available to the Working Group members are identified in Paragraphs 19(a) through (d).

The Right to Financial Privacy Act

The restrictions of the Right to Financial Privacy Act ("RFPA") have impeded the criminal referral process in a significant manner over the last several years. The Working Group members are unanimous in their belief that a clarifying amendment with respect to the customer notification requirements of the RFPA should be enacted for the transfer of information to the

Justice Department for its use in conducting a criminal investigation or prosecution. (Paragraph 20.) The current customer notice provisions of the RFPA are ill-advised in two major respects. When customers who are "victims" or who are otherwise uninvolved in the suspected criminal conduct, receive notice under the RFPA upon transfer of their financial records to the Justice Department, it causes unnecessary confusion and concern. However, when the suspected perpetrator of the crime receives such a notice, the Justice Department is concerned that he may take action to destroy evidence or otherwise to cover-up his wrongful conduct.

Because of these problems, the Working Group's Agreements provide that the Supervisory Agencies will implement procedures to ensure that criminal referrals are made in a manner that does not require notice to customers. (Paragraph 21.) This will sometimes result in referrals that omit the names of customers or copies of customer records of "protected" customers when the referrals are made, and which will require the issuance of Grand Jury subpoenas to obtain the omitted information without customer notice. However, the Working Group has agreed to operate under this procedure until and unless a corrective amendment to the RFPA is enacted. This does not mean that referrals will be abbreviated by not explaining fully the suspected crime; rather, the referral will omit identifying the protected customer or financial records only, and will otherwise report all of the pertinent facts requested on the referral form.

Equally important is the fact that the Working Group members have agreed to support a clarifying amendment to the RFPA that would provide an exception to the customer notice requirements for any transfers of information lawfully in the possession of one government authority (i.e., a Supervisory Agency) to another government authority (i.e., the Justice Department) for a law enforcement purpose. (Paragraph 20.)

The Bank Bribery Act

Paragraph 23 points out that the Working Group has addressed and will continue to pursue issues related to the new Bank Bribery Act at 18 U.S.C. § 215.

Continuation of the Working Group

Finally, the Working Group has agreed to continue its existence in order to complete the implementation of the matters agreed upon and to serve as a continuing *ad hoc* committee to discuss problems and to resolve matters of common interest and responsibility. (Paragraph 24.)

Exhibit 9

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington D C 20219

To David D. Queen, Deputy Assistant Secretary (Enforcement and Operations)

From John F. Downey, Chief National Bank Examiner J Downey

Date March 27, 1986

Subject Revised Bank Secrecy Act Examinations Procedures

Over the past several months, representatives of the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, National Credit Union Administration (NCUA) and your office have met to revise the BSA examination procedures. The working group has now completed the project.

With the exception of the NCUA, who is continuing to evaluate the final document, the working group has agreed upon the revised examination procedures. Each of the regulatory agencies will be responsible for the immediate distribution and implementation of the procedures.

Enclosed, for your use, is a copy of the revised procedures. If there are any questions, please contact me.

Enclosure

cc: Richard Schrieber, Board of Governors of the Federal Reserve System
Michael Bianchetta, Federal Deposit Insurance Corporation
Cynthia Graae, Federal Home Loan Bank Board
Hattie Ulah, National Credit Union Administration
Brian Bruh, Internal Revenue Service
Bill Landreth, Department of the Treasury

General

As a means to detect the incidence of money laundering, for any of a multitude of illicit activities, the Financial Recordkeeping and Reporting of Currency and Foreign Transactions Reporting Act, the Bank Secrecy Act, was enacted October 26, 1970. Among other things, the Act allows the Department of the Treasury (Treasury) to delegate certain compliance responsibilities to other governmental agencies. In an effort to ensure compliance with the Act by bank and nonbank financial institutions, Treasury delegated supervisory authority to the financial institution regulators.

Different methods are available for selecting financial institutions for examination. These include:

- Scheduled examinations - an identified core group of institutions which will be examined on a regular basis,
- Targeting - identifying financial institutions for special investigations based upon analyses of financial or other data, and/or
- Sampling - selecting institutions for examination by randomly sampling a specific population.

Each regulatory agency has its own policy which addresses the examination schedule. The use of the above methods is determined independently by each agency.

Procedural

The following procedures for testing compliance with Financial Recordkeeping and Reporting Regulations (Bank Secrecy Act), 31 CFR 103, are set forth in two separate modules which are progressively extensive in scope. The first module includes "stops" which provide the examiner with the opportunity to determine whether the examination can be concluded or whether the examiner should continue.

Module I requires the examiner to establish that the examined institution has appropriate operating and auditing standards. In addition, it requires the examiner to conduct a detailed review of the institution's internal audit function and entails the examination of procedures and selected workpapers, reports and responses. The review of auditing methodology and implementation enables the examiner to determine the scope of the examination.

Module II sets forth guidelines for the examiner in conducting a review of a sample of actual transactions and related documentation.

MODULE I

The purpose of this module is to determine that the financial institution under examination has established operating standards and audit procedures that ensure compliance with the requirements of the Financial Recordkeeping and Reporting of Currency and Foreign Transaction Act, 31 CFR 103.

It is recognized that the reporting requirements will not be applicable to those credit unions which do not conduct cash transactions.

PROCEDURES

1. The examiner should ascertain that the institution has established in writing formal operating procedures to ensure compliance with the regulations. Review the institution's policies and procedures, internal controls and training regarding the Act.

    a. Reporting -- Operating procedures should set forth the requirements of the regulations and establish compliance guidelines with respect to large cash transactions and exemptions granted to customers.

    b. Recordkeeping -- The institution's record retention schedule should, at a minimum, include the record retention requirements of the regulations. Furthermore, requirements for the maintenance of lists of exempt customers from whom taxpayer identification numbers have not been obtained should be included.

2. Obtain a copy of the institution's list of exempt customers and review the institution's correspondence with the Internal Revenue Service (IRS) or Department of the Treasury (Treasury) regarding exemptions. Through a review of these documents, determine:

    a. that the exemption list conforms to the requirements of the regulations (name, address, business, nine digit Federal taxpayer identification number, reason for exemption, etc.) (103.22(e)), and that the exemptions appear reasonable.

b. that the institution has, in granting exemptions, adhered to its established policy and has documentation to support the limits established.

c. if a denial for a special request for exemption from the reporting requirements has been sent to the institution. If so, ascertain that currency transaction reports are being filed on that customer when a reportable transaction occurs. If the number of denials is large, select a sample to review.

3. The examiner should review the file of reports submitted (forms 4789 and 4790) and ascertain that they are properly completed and filed as required. Review correspondence from IRS/Treasury to be cognizant of incorrect or incomplete CTRs returned to the institution for corrective action. Follow-up on the disposition of these forms.

4. The examiner should ascertain that the institution has established a program of employee education with regard to the requirements of the regulations.

   a. Tellers, through an ongoing training program, should be apprised of the reporting requirements for large cash transactions.

   b. Operations personnel should be made aware of the current requirements of the regulations and management should periodically reinforce the importance of compliance.

   c. Knowledge of the regulations and operating procedures should be ascertained by interviewing the following: the institution's management, auditors, internal control personnel, tellers, platform personnel, branch managers and personnel in cash vault operations.

   Determine if currency transactions are conducted in other areas of the institution such as the trust department, bank dealer department, loan department and international department. If so, ascertain that personnel which handle currency in these departments are knowledgable of the regulations and operating procedures. Determination of how these individuals became knowledgable of the regulations should be documented (i.e., initials on a circular, attendance at training sessions, attending seminars, etc.)

Procedure 5 is to be omitted if the institution does not have an internal audit function. In such cases, the examiner should ascertain that a program of management reviews or self audits has been established which encompasses the requirements of the regulations.

5. The examiner should test the institution's audit procedures and determine that internal audit function provides coverage of the following sections of the regulations.

    a. Reporting -- Coverage of the reporting requirements should be found in the procedures and should include a review of actual tellers' work and Forms 4789 and 4790.

    b. Recordkeeping -- Coverage of the institution's recordkeeping activities should encompass a test of adherence to the in-house record retention schedule. It is understood that this schedule should meet the requirements of the regulations.

    c. Exemptions -- Coverage should include audit steps necessary to ascertain that the institution is maintaining a list of exempt customers which includes their affiliations as required by the regulations. The examiner should expect the audit procedure to provide a test of the reasonableness of the exemptions granted.

    d. Foreign Accounts -- Coverage in this area should require the auditor to ascertain that the institution has filed Form 90-22.1, if applicable, declaring interest in a foreign financial account.

6. The examiner should review the results of the prior examination report and follow-up on any deficiencies.

7. The examiner should review the totals of cash shipped to and/or received from the Federal Reserve Bank (reported on Form MD-115) or correspondent bank during the last six months. If, in the examiner's judgement, that amount appears high in relation to the amount the institution has reported on Form 4789 for the last six months, the examiner should discuss the findings with management, substantiate the explanation and document it in the workpapers.

During this process the examiner may become aware of unusual currency flows from correspondent banks. If this occurs, the examiner should convey such findings to a supervisor. Ultimate dissemination should be made to other examiners or financial institution regulatory agencies.

STOP

At this point, the examiner has to exercise judgement in deciding whether further examination and testing is needed.

- o If the examiner is satisfied with the results from the steps above, the findings should be summarized in workpapers.
- o If, however, it is determined that further work is warranted, the examiner should implement Module II.

MODULE II

The purpose of this module is to conduct on-site examination of teller operations relative to Financial Recordkeeping and Reporting Regulations. This module sets out procedures and guidelines the examiner should use when conducting test checks for compliance with the regulations. Criteria for selection of branches for detailed review are listed along with general guidelines applicable to either multiple or single office financial institutions.

This phase of the examination should include a minimum of five to ten days of transactions and one to three branch offices. Branch examinations should encompass a review of the work of selected tellers within the days selected.

The selection of tellers should be governed by the institution's internal procedures. For example, if it is the institution's practice to direct all large currency transactions to specific tellers, the examiner may concentrate on the work of those tellers. In the absence of such procedures, or if the procedures are not being followed, the work of all tellers should be reviewed.

I. Complete Exhibits A and B: A Review of Currency Distribution/Cash Control Center and Branch Operations

  A. Submit Exhibit A, the Currency Distribution and Cash Control Center Letter and its attached Currency Shipment/Distribution Report to the Officer-in-Charge of the Center.

  B. If branches ship directly to a Federal Reserve Bank or a correspondent institution, then a copy of Exhibit A must be submitted to every branch that does ship currency directly to a Federal Reserve or correspondent institution.

  C. Check the records maintained at the currency distribution/cash control center or the branch to ensure that the information in those records is compatible with information provided by the Officer-in-Charge in Exhibit A and the guidelines outlined below. (See Section II)

  D. A Branch Office Letter (Exhibit B) should be personally addressed and sent to every branch.

II. Guidelines for Selection of Branches for On-Site Review

A. In reviewing the information provided in Exhibits A and B, examiners should use the following criteria to select branches for on-site review:

1. Branch requests for large denomination currency represent the most significant portions of their total branch currency requirements;

2. Branch requests for large denomination currency are significantly greater than average branch requirements;

3. Branch does not ship large denomination currency;

4. Branch reports no exempt list;

5. Branch manager would not sign the statement (Exhibit B); and

6. Branch is characterized by unusual cash transactions with the Cash Control Center, Federal Reserve Bank, or correspondent institution .

B. In the absence of significant leads, consider selection of branches for on-site review by sampling on a random basis.

III. General Guidelines for On-Site Review

A. When at the office location, the examiner is to review the work of selected tellers with a specific time period. (See above criteria for selection of tellers. Recommended time period: minimum five days, preferably ten days.) The examiner should take into account the time period allowed for filing forms 4789 or 4790 in selecting the time frame in which the examination will be conducted. For example, if the date of examination is 12/31/80, the grace period for filing is 15 days, and the examiner is reviewing transactions for two weeks, or 14 days, then the examiner should review transactions at least 29 days before 12/31/80.

B. Obtain, for selected tellers, completed cash proof sheets for as many consecutive dates as are practical. From a day-to-day comparison of total $50 and $100 bills, determine specific tellers who experienced a significant ($10,000) fall-off in these denominations that is not supported by the tellers' transactions. Incidents of this type should be reported to the examiner-in-charge as possible evidence of currency washing.

IV. Review Procedures for Selected Tellers and Selected Dates

A. Obtain and review tellers' documentation for the selected dates.

B. Note any cash-in or cash-out transactions of more than $10,000.

C. In instances where such transactions were discovered, determine the type of transaction and if it was reported. Transactions with non-exempt customers which were not reported should be researched to ascertain if they are truly subject to the regulation.

D. Review consecutive transactions which total in excess of $10,000 to ascertain if they were made by or for one depositor.

E. The following transactions should be checked. While performing the following steps, the examiner should be aware of repetitive currency transactions by a customer or in an account or group of accounts controlled by one entity. Based on the activity, the customer or account(s) may be targeted for additional investigation of currency transactions occurring in different time periods.

1. Cashed checks -- Items should be traced to ascertain if they are a cash-out of more than $10,000 or part of a split transaction. Split transactions which do not involved a cash-out of more than $10,000 should be eliminated.

2. Cash deposits -- Any transaction involving the receipt of more that $10,000 cash.

3. Savings withdrawal -- Cash withdrawals of more than $10,000.

4. Personal money orders or official checks sold -- Any sale for more than $10,000 cash must be reported, even to an exempt customers. Be aware of consecutive items sold. A check of paid items could reveal that they were sold to the same customer.

5. Savings bonds sold or cashed -- Transactions involving more than $10,000 cash.

6. Official checks cashed -- Cash-outs of more than $10,000.

7. Loans -- Note teller receipt or pay-out of more than $10,000 cash.

8. Securities sold or purchased -- If the institution acts as agent for an individual and the transactions involves more than $10,000 cash.

9. Fiduciary powers -- if the institution's trust department is conducting currency transactions for customers which exceed $10,000.

10. Wire department -- wire transfer and telex logs to determine cash transactions exceeding $10,000.

11. Other areas -- investigate other areas of the institution where currency transactions exceeding $10,000 may be occurring.

F. The examiner should obtain and review the list of exempt customers. Lists which appear inordinately long or which contain names of customers the size or nature of whose business would not ordinarily merit exempt status should be discussed with management of the institution under examination. If after discussion with management the examiner feels that criticism may still be warranted, the matter should be referred to the examiner's supervision department or district office.

V. List Exceptions for Possible Inclusion in the Report of Examination/Supervisory Letter

A. Determine the severity of noncompliance with the Act and management's attitude toward compliance. Violations and poor internal controls may warrant a civil or criminal referral to the Department of the Treasury. Report comments should not include references regarding the willfulness of a violation or act on the part of the institution or its employees.

CURRENCY DISTRIBUTION AND CASH CONTROL CENTER LETTER

Date:____________

____Officer-in-Charge Branch#:__________
Currency Distribution/Cash Control Center

____Location

Dear Sir/Madam:

In order to facilitate our review for compliance with Financial Recordkeeping and Reporting Regulations, please submit the following information. Supporting source records should be made available for review upon request.

____
Examiner

Please provide, according to the attached format, the following information for the period ________________ to ________________, inclusive.

1) For branches which ship and receive currency through a central currency distribution center within the institution please provide:

   a) A list of all currency shipments between the distribution center and the Federal Reserve Bank or correspondent institution;

   b) A list, by branch, of all currency shipments between the distribution center and branches;

   c) A list of currency shipments between branches;

   d) A list of branches which have shown a significant increase in their use of large bills during the past twelve months, either as a portion of their total shipment of currency or in comparison to other branches.

2) For branches which transact (ship and/or receive currency) with the Federal Reserve Bank or correspondent institution;

   a) A list of all currency transactions between the branch and the Federal Reserve Bank or correspondent institution;

   b) A list of all currency transactions with other branches.

3) Copies of all correspondence with the Department of the Treasury or the Internal Revenue Service regarding exemption lists, requests for special exemptions and incorrectly filed CTRs.

Signed ________________________
(Title and Position)

CURRENCY SHIPMENT/DISTRIBUTION REPORT

from ____________ to ___________

Officer-in-Charge ______________________

Institution Name ______________________

Location ______________________

CURRENCY RECEIVED				CURRENCY SHIPPED			
Date	Received from	Total amount of shipment	Total amount of large ($50's & $100's bills)	Date	Shipped to	Total amount of shipment	Total amount of large ($50's & $100's bills)

(Signed) ______________________
(Title and Position)

____
Date

Exhibit B

BRANCH OFFICE LETTER

Date:____________________

____________________, Officer-in-Charge

____________________, (Office)

____________________, (Location)

Dear Sir/Madam:

To facilitate our examination of compliance with Financial Recordkeeping and Reporting Regulations under Public Law 91-508, please furnish the examiner-in-charge with the information listed below.

____
Examiner

1) A copy of your list of customers who normally have currency transactions over $10,000 (exempt customers).

2) Describe how currency transactions over $10,000 for customers are recorded and reported by individual tellers at your office.

3) Describe the records used at your office to document, by denomination, currency transfers between tellers, including transfer from and to vault cash.

4) Name of person in your office who is responsible for filing Currency Transaction Reports (Form 4789).

5) Indicate where copies of all Currency Transaction Reports (Form 4789) prepared by your office are maintained.

6) A list of transactions for which Currency Transaction Reports (Form 4789) are due to be filed but have not yet been submitted by your office.

7) If periodic reviews are conducted by office management of exempt customers to ensure that their status has not changed under Recordkeeping and Reporting Regulations, please make supporting documentation available, including:

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a) dates of last two reviews;
b) description of work reviewed;
c) names of individuals who conducted the review and their findings.

* * * * * *

Currency Transaction Reports (Form 4789) have been completed for all required transactions. Lists of customers who normally have currency transactions over $10,000 (exempt customers) are currently maintained.

(Signed)______________________
Office Manager

Exhibit [illegible]

FEDERAL HOME LOAN BANK BOARD
OFFICE OF EXAMINATIONS AND SUPERVISION
WASHINGTON, D.C.

BULLETIN PA-7a-3

RESPONSIBILITY OF INDEPENDENT PUBLIC ACCOUNTANTS UNDER THE CURRENCY AND FOREIGN TRANSACTION REPORTING ACT (a.k.a. THE BANK SECRECY ACT)

Insurance Regulation Section 563.17-1(a)(2) requires each insured institution and service corporation thereof to be audited at least once in each calendar year in a manner satisfactory to the Corporation. The basic guidelines for the independent public accountants (auditors) to follow are contained in Bulletin PA-7a, dated March 20, 1975 (as modified on May 4, 1977) and Bulletin PA-7a-2 dated June 6, 1984. The purpose of this bulletin is to outline the auditors' responsibilities under the Currency and Foreign Transactions Reporting Act (a.k.a. the Bank Secrecy Act).

On May 23, 1985, the Federal Home Loan Bank Board's (FHLBB) Office of Examinations and Supervision issued T Memorandum 53-7. This memorandum outlines the requirements of the Bank Secrecy Act and discusses the particular concerns of the FHLBB. A copy of T Memorandum 53-7 is attached to this bulletin for reference purposes. The following sets forth the minimum audit procedures that must be followed relative to the requirements of the Bank Secrecy Act in order for an annual audit to be satisfactory to the Corporation.

1. Determine that the insured institution has the necessary system of internal controls, policies and procedures to comply with the Act.

2. Test check for compliance with the same.

3. File a special report as prescribed by Statement of Auditing Standards No. 14 (as amended), Special Reports reporting the results of the review and test of compliance. This report shall be filed in accordance with paragraph VII of Bulletin PA-7a.

It will be the responsibility of the independent public accountant to keep abreast of any changes or amendments to the Bank Secrecy Act that may affect the compliance requirements of the insured institutions.

This Bulletin will be effective for fiscal years ending after January 1, 1986.

William J. Schilling
Director

Attachment

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

MEMORANDUM #T 53-7

TO: OES Professional Staff

May 23, 1985

FROM: William J. Schilling

Currency and
Foreign
Transactions
Reporting Act
(a.k.a. the
Bank Secrecy Act)

SYNOPSIS: REQUIREMENTS OF THE BANK SECRECY ACT AND PARTICULAR CONCERNS OF THE BOARD DISCUSSED.

There is recent evidence of a lack of compliance with the Currency and Foreign Transactions Reporting Act, also known as the Bank Secrecy Act ("BSA"), by some financial institutions. This memorandum is written to remind the staff of our accountability for securing FSLIC-insured institutions compliance with the BSA and to ensure that management officials of all such institutions understand their responsibilities under the act.

The fundamental purpose of the BSA is to provide a paper trail of the activities of money launderers serving the interests of drug traffickers and other elements of white collar and organized crime. Among the most basic requirements of the BSA is the filing of Forms 4789 and 4790. All financial institutions must file Form 4789 with the Internal Revenue Service when currency transactions in excess of $10,000 occur. Form 4790 is required to be filed with the Commissioner of Customs when currency in excess of $10,000 is or is attempted to be transported from or to the United States or, if not filed by the sender, when currency in excess of $5,000 is received from any place outside the United States. (Until recently, filing of Form 4790 was required for the transportation of currency in excess of $5,000 from or to the United States, but pursuant to a statutory amendment this was changed and the requirement is as described in the preceding sentence. The Department of the Treasury ("Treasury") is in the process of amending the applicable regulation -- 31 CFR §103.23(a).) As used in the BSA, "currency" includes coin and currency of the United States or other countries, and United States and Federal Reserve notes, but does not include bank checks or other negotiable instruments not customarily accepted as money.

Section 103.22(b) of Treasury's regulations provides that an insured institution may exempt certain types of customers (such as retail establishments, sports arenas, and restaurants) who regularly deal in large amounts of currency and thereby avoid the requirement of filing Form 4789 for certain deposits and withdrawals. However, a record of each exemption containing information specified by Treasury's regulations must be kept in a central location. The legality and reasonableness of these exemptions is of particular concern to Treasury and to this agency.

Experience has shown that many institutions that are unaware of their responsibilities under the BSA have neglected to give new employees detailed training concerning those responsibilities or to regularly check with their employees to determine if compliance is occurring. If it has not already been done, the management of each insured institution should (1) establish training programs or otherwise secure training that sets forth the requirements of Treasury's regulations, and (2) establish operating procedures and compliance guidelines. Each of these should be available to all employees that come into contact with currency transactions. The institution's management should consider including the following in its compliance program:

(a) requiring centralized control and review of compliance with the BSA;

(b) encouraging the reporting of large deposits consisting of numerous and/or out-of-area items of less than $10,000;

(c) encouraging the reporting of any unusual or suspicious purchase of cashier's checks, official checks, money orders, etc. by non-customers; and

(d) verifying the identity of non-customers purchasing such items from identity cards with pictures.

Each institution's procedures for BSA compliance should be regularly tested by the institution's auditors or by management personnel not directly involved in this area of operation. The method of testing also should be documented. Examiners should continue to determine that institutions have instituted appropriate operating and auditing standards. Records required by Treasury's regulations should generally be retained for five years.

When violations are discovered by auditors or an institution itself, management should discuss them with Treasury. The applicable district office of the Board's Office of Examinations and Supervision should be notified of such discussions. Institutions are reminded that the Board reports all violations to the Treasury on a twice-yearly basis, and that failure to comply with the law can result in criminal or civil penalties.

Any institution that is uncertain of the application of the BSA to transactions in which it takes part should undertake immediately to educate itself through the many publications in this area or by consulting legal counsel or other professional assistance. Liaison with the office of the Supervisory Agent should continue to be maintained.

William Schilling
William J. Schilling
Director

Distribution to State supervisory authorities to be made by District Directors-Examinations.

Exhibit

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

MEMORANDUM AB [illegible]

TO : Principal Supervisory Agents March 20, 1986

FROM: Francis M. Passarelli

Currency and Foreign
Transactions
Reporting Act
(a.k.a. the Bank
Secrecy Act)

Attached is an IRS news release dated December 27, 1985, relating to the implementation of Treasury Department Order 105-13. (Please refer to AB 63 for the text of the order.) The release promulgates the IRS' assumption of responsibility (as of January 1, 1986) for review of exemption lists of financial institutions and for approval or denial of individual requests for exemption from the currency transactions reporting requirements of the Bank Secrecy Act.

Please distribute the attached news release to your insured members and advise them that they may direct questions concerning exemptions, exemption lists and special exemptions to the IRS by writing the Data Center at the address indicated in the news release or by calling (202) 566-6471.

Francis Passarelli
Acting Director

Attachment

cc: Professional Staff - Examinations and Supervision

News Release

Department of the Treasury
Internal Revenue Service
Public Affairs Division
Washington, DC 20224

Media Contact Tel (202) 566-4024
Copies Tel (202) 566-4054

For Release: 12/27/85

IR-85-125

Washington--In a move designed to increase its effectiveness in combatting illegal money laundering, the Internal Revenue Service today said it will assume responsibility on Jan. 1, 1986, for reviewing exemption lists of financial institutions, as well as approving or denying individual requests for exemption from the currency transactions reporting requirements of the Bank Secrecy Act.

The increased authority under the Bank Secrecy Act was delegated to the IRS by the Department of the Treasury.

The IRS also said it is authorized to begin investigations of banks and brokers or dealers in securities for possible criminal violations of the Bank Secrecy Act. In addition, the IRS now has responsibility to assure that all banks not now examined by federal bank supervisory agencies for safety and soundness are in compliance with the currency transaction reporting requirements.

Filings of currency transaction reports almost tripled during 1985 -- from an average of 60,000 per month to more than 170,000, the IRS said. Explaining the increase, the IRS credited the strong enforcement of the Bank Secrecy laws, expecially in some well publicized cases in the recent past.

The IRS will request from banks and other financial institutions the list of their customers who have been granted exemption from the reporting requirements. It will review these lists and direct the institutions to remove the names of customers with unacceptable exemptions and to file currency transaction reports on those customers.

(More)

The IRS noted that the delegation of exemption authority is not exclusive and that authority for resolving interpretative matters will remain with the Secretary of the Treasury.

Banks and similar financial institutions should address requests for exemptions to the Internal Revenue Service, P.O. Box 32063, Detroit MI 48232.

X X X

Exhibit 12

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

MEMORANDUM

T 53b

TO: Professional Staff -
Examinations and Supervision

February 3, 1986

FROM: Francis M. Passarelli

Currency and Foreign
Transaction Reporting Act

SYNOPSIS: AMENDMENTS TO REGULATIONS IMPLEMENTING CURRENCY AND FOREIGN TRANSACTIONS REPORTING ACT ARE CONSOLIDATED

Note: The Treasury Department regulations implementing the Currency and Foreign Transactions Reporting Act (also known as the Bank Secrecy Act) have been amended several times since they were first issued in 1972. Through additions to T 53, the Office of Examinations and Supervision has distributed these amendments. However, keeping track of the various amendments has become cumbersome. Therefore, the purpose of this memorandum (T 53b) is to distribute a copy of the amended regulations in their entirety. The regulations are up-to-date as of the issuance of this memorandum and include the October 22, 1985, regulatory amendments. T 53b supersedes memorandum T 53, T 53a, T 53-1(a), T 53-3, T 53-4 and T 53-5, since it consolidates the information in those memoranda, which pertain to regulatory amendments. Memoranda T 53-6 and T 53-7, which discuss accountability for compliance, remain in effect.

This memorandum discusses three principal sections of the Regulations: taxpayer identification numbers, currency transaction reports, and reports of international transportation of currency or monetary instruments.

Taxpayer Identification Numbers

Regulations prescribed by the Department of the Treasury, which implement provisions of the Currency and Foreign Transactions Reporting Act, (31 U.S.C. 5311-23), require savings and loan associations and other financial institutions, to obtain and keep a record of the taxpayer identification number of any person or entity residing or doing business in the United States and opening a deposit or share account after June 30, 1972, or selling or redeeming a certificate of deposit after May 31, 1978.

In a memorandum of June 19, 1978, explaining the importance of the regulatory amendment that requires the maintenance of data with regard to the selling or redeeming of certificates of deposit, the Treasury Department stated that it had become:

> evident that use of negotiable bearer certificates has not been confined to legitimate financial purposes. These certificates have been issued in small denominations and have been sold to the public in a manner suggesting that they could be used to evade taxes. In addition, there is some evidence that they are being purchased by drug traffickers.

For individuals, the taxpayer identification number is the social security number; corporations, trusts, partnerships, nonprofit organizations and other entities will be identified by the IRS employer identification number. If an account is opened in the names of more than one individual, the association is required to obtain and maintain a record of the social security number of at least one individual who has a financial interest in that account. In addition:

1. Financial institutions are required only (a) to make a reasonable effort to obtain a copy of a taxpayer's identification number and (b) to maintain a list of those persons who have failed to provide such a number after a 45-day period. (Section 103.34(a)(1)).

2. Taxpayer identification numbers need not be secured in every instance; most notably they are not needed with respect to accounts for (a) certain public funds, (b) certain aliens, including non-resident aliens who are not engaged in a trade or business in the United States, and (c) Christmas Club and school savings plans where annual interest does not exceed $10. (Section 103.34(a)(3)).

3. Financial institutions need not secure and maintain a record of the taxpayer identification number of savings accounts opened by judges, public officials and clerks of courts of record acting as custodians of funds in controversy or under the control of the court. "Funds in controversy" are of a nature of funds held by such officials for unknown heirs, minors without guardians, or estates without administrators or executors. (Section 103.34(a)(3).

4. Where a financial institution acts as an intermediary in the purchase or redemption of a marketable certificate of deposit, the agent institution is required to maintain records on the purchaser and the person presenting the certificate for payment. The recordkeeping requirements of the issuing financial institution pertain only to recording the identity of the agent, a description of the instrument and the date of the transaction. (Section 103.34(a)(1)).

Currency Transaction Reports

The Treasury regulations require that a financial institution generally must file a Currency Transaction Report (IRS Form 4789) for each deposit, withdrawal, exchange of currency or other payment or transfer by, through, or to the financial institution which involves a transaction in currency of more than $10,000. However, the regulations provide that a bank (defined to include S&Ls) need not prepare a Currency Transaction Report for currency transactions with certain types of established customers, including most retail businesses, operators of hotels and restaurants and certain types of amusements, when the transaction amounts are commensurate with the customary conduct of the business, industry or profession of the customer. The institution must make a record of each exemption and the reason for the exemption at the time it is granted. The regulations also require an institution (a) to maintain a centralized list of the exemptions, and (b) upon the request of the Secretary of the Treasury, to submit the list to the Secretary. In addition:

> Section 103.22 further limits a financial institution's authority to exempt transactions from the reporting requirements. Also, paragraph (e) requires a financial institution to make and retain a record of the authorization of such exemptions.
>
> Section 102.26(a) requires a financial institution to file the Currency Transaction Report within 15 days following the day on which a transaction occurs, and to retain a copy of the report for 5 years.
>
> Section 103.27 requires a financial institution to verify and record the identity of the individual presenting the transaction, as well as the identity, account number, and the social security number or the taxpayer identification number, if any, of any person or entity for whose account the transaction is being made.

The Supreme Court of the United States has upheld as constitutional the domestic reporting requirements of the Currency and Foreign Transactions Reporting Act (Sections 103.22, 103.26(a) and 103.27 of the regulations).

International Transportation of Currency or Monetary Instruments

The regulations also require that any person, including a financial institution, who physically transports, mails, or ships (or causes or attempts to do so) currency or other monetary instruments in excess of $10,000 from the United States to any place outside the United States, or any person, including a financial institution, receiving from outside the United States currency or monetary instruments in excess of $5,000 for which such report has not been filed must file a Form 4790 with the United States Customs Service. The regulations define "monetary instruments" as:

> Coin or currency of the United States or of any other country, travelers' checks, money orders, investment securities in bearer form or otherwise in such form that title thereto passes upon delivery, and negotiable instruments (except warehouse receipts or bills of lading) in bearer form or otherwise in such form that title thereto passes upon delivery. The term includes bank checks, travelers' checks and money orders which are signed but on which the name of the payee has been omitted, but does not include bank checks, travelers' checks or money orders made payable to the order of a named person which have not been endorsed or which bear restrictive endorsements.

As indicated above, bank checks, travelers' checks and money orders which are signed but on which the name of the payee has been omitted are specifically included in the revised definition. They are specifically excluded when not endorsed or when restrictively endorsed.

Attached for your information and guidance are the implementing regulations, which include amendments through October 22, 1985, Form 4789 and Form 4790. Copies of Form 4789 may be obtained from the Internal Revenue Service. Copies of Form 4790 may be obtained from the U.S. Customs Service.

Also attached for your information is a copy of a January 30, 1973 notice published by the Treasury Department. The notice describes the proper procedures for financial institutions to follow in obtaining tax identification numbers.

During each examination of an insured institution attention should be given to these requirements, and appropriate action should be taken by both the examining staff and the Board's Supervisory Agents whenever needed to assure compliance.

Acting Director

Attachments

31 CFR 103 July 1, 1985 Edition with
amendments from 50 FR 27821, July 8, 1985
and 50 FR 42691, Oct. 22, 1985

PART 103—FINANCIAL RECORDKEEPING AND REPORTING OF CURRENCY AND FOREIGN TRANSACTIONS

Subpart A—Definitions

Sec.
103.11 Meaning of terms.

Subpart B—Reports Required To Be Made

103.21 Determination by the Secretary.
103.22 Reports of currency transactions.
103.23 Reports of transportation of currency or monetary instruments.
103.24 Reports of foreign financial accounts.
103.25 Filing of reports.
103.26 Identification required.

Subpart C—Records Required To Be Maintained

103.31 Determination by the Secretary.
103.32 Records to be made and retained by persons having financial interests in foreign financial accounts.
103.33 Records to be made and retained by financial institutions.
103.34 Additional records to be made and retained by banks.
103.35 Additional records to be made and retained by brokers or dealers in securities.
103.36 Additional records to be made and retained by casinos.
103.37 Nature of records and retention period.
103.38 Person outside the United States.

Subpart D—General Provisions

103.41 Dollars as including foreign currency.
103.42 Photographic or other reproductions of Government obligations.
103.43 Availability of information.
103.44 Disclosure.
103.45 Exceptions, exemptions, and reports.
103.46 Enforcement.
103.47 Civil penalty.
103.48 Forfeiture of currency or monetary instruments.
103.49 Criminal penalty.
103.50 Enforcement authority with respect to transportation of currency or monetary instruments.
103.51 Access to records.
103.52 Rewards for informants.
APPENDIX—INTERPRETATIONS AND EXEMPTIONS

Authority: Sec. 21 of the Federal Deposit Insurance Act, Pub. L. 91–508, Title I, 84 Stat. 1114, 1116 (12 U.S.C. 1829b, 1951, 1959); and the Currency and Foreign Transactions Reporting Act, Pub. L. No. 91–508, Title II, 84 Stat. 1118, as amended (31 U.S.C. 5311–22).

and the Currency and Foreign Transactions Reporting Act, 84 Stat. 1118, 31 U.S.C. 1051-1122, unless otherwise noted.

SOURCE: 37 FR 6912, Apr. 5, 1972, unless otherwise noted.

Subpart A—Definitions

§ 103.11 Meaning of terms.

When used in this part and in forms prescribed under this part, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in this section.

(a) *Bank.* Each agent, agency, branch or office within the United States of any person doing business in one or more of the capacities listed below:

(1) A commercial bank or trust company organized under the laws of any State or of the United States;

(2) A private bank;

(3) A savings and loan association or a building and loan association organized under the laws of any State or of the United States;

(4) An insured institution as defined in section 401 of the National Housing Act;

(5) A savings bank, industrial bank or other thrift institution;

(6) A credit union organized under the laws of any State or of the United States; and

(7) Any other organization chartered under the banking laws of any State and subject to the supervision of the bank supervisory authorities of a State.

(8) A bank organized under foreign law.

(b) *Broker or dealer in securities.* A broker or dealer in securities, registered or required to be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

(c) *Currency.* The coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance. Currency includes U.S. silver certificates, U.S. notes and Federal Reserve notes. Currency also includes official foreign bank notes that are customarily used and accepted as a medium of exchange in a foreign country.

(d) *Domestic.* When used herein, refers to the doing of business within the United States, and limits the applicability of the provision where it appears to the performance by such institutions or agencies of functions within the United States.

(e) *Financial institution.* Each agency, branch, or office within the United States of any person doing business in one or more of the capacities listed below:

(1) A bank (except bank credit card systems);

(2) A broker or dealer in securities;

(3) A person who engages as a business in dealing in or exchanging currency as, for example, a dealer in foreign exchange or a person engaged primarily in the cashing of checks;

(4) A person who engages as a business in the issuing, selling, or redeeming of travelers' checks, money orders, or similar instruments, except one who does so as a selling agent exclusively or as an incidental part of another business;

(5) A licensed transmitter of funds, or other person engaged in the business of transmitting funds abroad for others.

(6) (i) A casino or gambling casino licensed as a casino or gambling casino by a State or local government and having gross annual gaming revenue in excess of $1,000,000.

(ii) A casino or gambling casino includes the principal headquarters and any branch or place of business of the casino or gambling casino.

(f) *Foreign bank.* A bank organized under foreign law, or an agency, branch or office located outside the United States of a bank. The term does not include an agent, agency, branch or office within the United States of a bank organized under foreign law.

(g) *Foreign financial agency.* A person acting outside the United States for a person (except for a country, a monetary or financial authority acting as a monetary or financial authority, or an international financial institution of which the United States Government is a member) as a financial institution, bailee, depository trustee, or agent, or acting in a similar way related to money, credit, securities, gold, or a transaction in money, credit, securities, or gold.

(h) *Investment security.* An instrument which:

(1) Is issued in bearer or registered form;

(2) Is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment;

(3) Is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(4) Evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

(i) *Monetary instruments.* Coin or currency of the United States or of any other country, travelers' checks, money orders, investment securities in bearer form or otherwise in such form that title thereto passes upon delivery, and negotiable instruments (except warehouse receipts or bills of lading) in bearer form or otherwise in such form that title thereto passes upon delivery. The term includes bank checks, travelers' checks and money orders which are signed but on which the name of the payee has been omitted, but does not include bank checks, travelers' checks or money orders made payable to the order of a named person which have not been endorsed or which bear restrictive endorsements.

(j) *Person.* An individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, and all entities cognizable as legal personalities.

(k) *Secretary.* The Secretary of the Treasury or any person duly authorized by the Secretary to perform the function mentioned.

(l) *Transaction in currency.* A transaction involving the physical transfer of currency from one person to another. A transaction which is a transfer of funds by means of bank check, bank draft, wire transfer, or other written order, and which does not include the physical transfer of currency is not a transaction in currency within the meaning of this part.

(m) *United States.* The various States, the District of Columbia, the Commonwealth of Puerto Rico, and the territories and possessions of the United States.

[37 FR 6912, Apr. 5, 1972, as amended at 38 FR 2175, Jan. 22, 1973; 41 FR 27832, July 7, 1976; 50 FR 5068, Feb. 6, 1985]

50 FR 27821, July 8, 1985;
50 FR 42691, Oct. 22, 1985.

Subpart B—Reports Required To Be Made

§ 103.21 Determination by the Secretary.

The Secretary hereby determines that the reports required by this subpart have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.

§ 103.22 Reports of currency transactions.

(a) (1) Each financial institution other than a casino shall file a report of each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or to such financial institution, which involves a transaction in currency of more than $10,000.

(2) Each casino shall file a report of each deposit, withdrawal, exchange of currency, gambling tokens or chips, or other payment or transfer by, through, or to such casino which involves a transaction in currency of more than $10,000.

(b)(1) Except as otherwise directed in writing by the Assistant Secretary (Enforcement and Operations), this section shall not: (i) Require reports of transactions with Federal Reserve Banks or Federal Home Loan banks; (ii) require reports of transactions between domestic banks; or (iii) require reports by nonbank financial institutions of transactions with commercial banks.

(2) Except as otherwise directed in writing by the Assistant Secretary (Enforcement and Operations), a bank may exempt from the reporting requirement of this section the following:

(i) Deposits or withdrawals of currency from an existing account by an established depositor who is a United States resident and operates a retail type of business in the United States.

For the purpose of this subsection, a retail type of business is a business primarily engaged in providing goods to ultimate consumers and for which the business is paid in substantial portion by currency, except that dealerships which provide automobiles, boats or airplanes are not included and their transactions are not exempt from the reporting requirement of this section.

(ii) Deposits or withdrawals of currency from an existing account by an established depositor who is a United States resident and operates a sports arena, race track, amusement park, bar, restaurant, hotel, check cashing service licensed by state or local governments, vending machine company, or theater.

(iii) Deposits, or withdrawals, exchanges of currency or other payments and transfers by local or state governments, or the United States or any of its agencies or instrumentalities.

(iv) Withdrawals for payroll purposes from an existing account by an established depositor who is a United States resident and operates a firm that regularly withdraws more than $10,000 in order to pay its employees in currency.

(c) In each instance the transactions exempted under paragraph (b) of this section must be in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the lawful, domestic business of that customer, or in the case of transactions with a local or state government or the United States or any of its agencies or instrumentalities, in amounts which are customary and commensurate with the authorized activities of the agency or instrumentality. This section does not permit a bank to exempt its transactions with a nonbank financial institution.

(d) A bank may apply to the Secretary for additional authority to grant an exemption to the reporting requirement, not otherwise provided for under paragraph (b) of this section, if the bank believes that circumstances warrant such an exemption. Such requests should be addressed to:

Exemption Staff, Room 1134, Office of Enforcement and Operations, U.S. Treasury Department, Washington, D.C. 20220.

(e) A record of each exemption granted under paragraph (b) of this section and the reason therefor must be made at the time it is granted and all such exemptions must be kept in a centralized list. The record shall include the names and addresses of the banks referred to in paragraph (b)(1)(ii) of this section, as well as the name, address, business, taxpayer identification number, and account number of each depositor that has engaged in currency transactions which have not been reported because of the exemption provided in paragraph (b)(2) of this section. The record concerning the group of depositors exempted under the provisions of paragraph (b)(2) of this section should also indicate whether the exemption covers withdrawals, deposits, or both, as well as the dollar limit of the exemption. Upon the request of the Secretary, a bank shall provide a report containing the list of the bank's customers whose transactions have been exempted in accordance with the provisions of paragraph (b) of this section and such information as the Secretary may require. The exemptions may be reviewed by the Secretary who may require a bank to file the usual reports as prescribed in paragraph (a) of this section with respect to any customer whose transactions have been previously exempted.

(f) Reports required under paragraph (e) of this section must be mailed or otherwise delivered to the Secretary within 30 days after the bank receives the Secretary's request.

(The information collection requirements contained in paragraph (a) were approved by the Office of Management and Budget under control number 1505-0087)

[45 FR 37820, June 5, 1980, as amended at 50 FR 5068, Feb. 6, 1985] 50 FR 42693, Oct. 22, 1985.

§ 103.23 Reports of transportation of currency or monetary instruments.

(a) Each person who physically transports, mails, or ships, or causes to be physically transported, mailed, or shipped, or attempts to physically transport, mail or ship, or attempts to cause to be physically transported, mailed or shipped, currency or other monetary instruments in an aggregate amount exceeding $10,000 on any one occasion from the United States to any place outside the United States, or into the United States from any place outside the United States, shall make a report thereof. A person is deemed to have caused such transportation, mailing or shipping when he aids, abets, counsels, commands, procures, or requests it to be done by a financial institution or any other person.

(b) Each person who receives in the U.S. currency or other monetary instruments in an aggregate amount exceeding $5,000 on any one occasion which have been transported, mailed, or shipped to such person from any place outside the United States with respect to which a report has not been filed under paragraph (a) of this section, whether or not required to be filed thereunder, shall make a report thereof, stating the amount, the date of receipt, the form of monetary instruments, and the person from whom received.

(c) This section shall not require reports by (1) a Federal Reserve bank, (2) a bank, a foreign bank, or a broker or dealer in securities, in respect to currency or other monetary instruments mailed or shipped through the postal service or by common carrier, (3) a commercial bank or trust company organized under the laws of any State or of the United States with respect to overland shipments of currency or monetary instruments shipped to or received from an established customer maintaining a deposit relationship with the bank, in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the business, industry or profession of the customer concerned, (4) a person who is not a citizen or resident of the United States in respect to currency or other monetary instruments mailed or shipped from abroad to a bank or broker or dealer in securities through the postal service or by common carrier, (5) a common carrier of passengers in respect to currency or other monetary instruments in the possession of its passengers, (6) a common carrier of goods in respect to shipments of currency or monetary instruments not declared to be such by the shipper, (7) a travelers' check issuer or its agent in respect to the transportation of travelers' checks prior to their delivery to selling agents for eventual sale to the public, (8) nor by a person engaged as a business in the transportation of currency, monetary instruments and other commercial papers with respect to the transportation of currency or other monetary instruments overland between established offices of banks or brokers or dealers in securities and foreign persons.

(d) A transfer of funds through normal banking procedures which does not involve the physical transportation of currency or monetary instruments is not required to be reported by this section. This section does not require that more than one report be filed covering a particular transportation, mailing or shipping of currency or other monetary instruments with respect to which a complete and truthful report has been filed by a person. However, no person required by paragraph (a) or (b) of this section to file a report shall be excused from liability for failure to do so if, in fact, a complete and truthful report has not been filed.

[37 FR 26517, Dec. 13, 1972, as amended at 50 FR 18479, May 1, 1985]

§ 103.24 Reports of foreign financial accounts.

Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Secretary for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons. Persons having a financial interest in 25 or more foreign financial accounts need only note that fact on the form. Such persons will be required to provide detailed information concerning each account when so requested by the Secretary or his delegate.

[42 FR 63774, Dec. 30, 1977]

§ 103.25 Reports of transactions with foreign financial agencies.

(a) *Promulgation of reporting requirements.* The Secretary, when he deems appropriate, may promulgate regulations requiring specified financial institutions to file reports of certain transactions with designated foreign financial agencies. If any such regulation is issued as a final rule without notice and opportunity for public comment, then a finding of good cause for dispensing with notice and comment in accordance with 5 U.S.C. 553(b) will be included in the regulation. If any such regulation is not published in the Federal Register, then any financial institution subject to the regulation will be named and personally served or otherwise given actual notice in accordance with 5 U.S.C. 553(b).

(b) *Information subject to reporting requirements.* A regulation promulgated pursuant to paragraph (a) of this section shall designate one or more of the following categories of information to be reported:

(1) Checks or drafts, including traveler's checks, received by respondent financial institution for collection or credit to the account of a foreign financial agency, sent by respondent financial institution to a foreign country for collection or payment, drawn by respondent financial institution on a foreign financial agency, drawn by a foreign financial agency on respondent financial institution—including the following information.

(i) Name of maker or drawer;

(ii) Name of drawee or drawee financial institution;

(iii) Name of payee;

(iv) Date and amount of instrument;

(v) Names of all endorsers.

(2) Wire or electronic fund transfers received by respondent financial institution from a foreign financial agency or sent by respondent financial institution to a foreign financial agency—including the following information:

(i) Name of foreign financial agency;

(ii) Name, address and account number of account being credited or debited by respondent financial institution;

(iii) Name of respondent financial institution;

(iv) Date and amount of each transfer;

(v) Any other information normally appearing on respondent financial institution's internal wire or electronic fund transfer entries.

(3) Loans made by respondent financial institution to or through a foreign financial agency—including the following information:

(i) Name of borrower;

(ii) Name of person acting for borrower;

(iii) Date and amount of loan;

(iv) Terms of repayment;

(v) Name of guarantor;

(vi) Rate of interest;

(vii) Method of disbursing proceeds;

(viii) Collateral for loan.

(4) Commercial paper received or shipped by the respondent financial institution—including the following information:

(i) Name of maker;

(ii) Date and amount of paper;

(iii) Due date;

(iv) Certificate number;

(v) Amount of transaction.

(5) Stocks received or shipped by respondent financial institution—including the following information:

(i) Name of corporation;

(ii) Type of stock;

(iii) Certificate number;

(iv) Number of shares;

(v) Date of certificate;

(vi) Name of registered holder;

(vii) Amount of transaction.

(6) Bonds received or shipped by respondent financial institution—including the following information:

(i) Name of issuer;

(ii) Bond number;

(iii) Type of bond series;

(iv) Date issued;

(v) Due date;

(vi) Rate of interest;

(vii) Amount of transaction;

(viii) Name of registered holder.

(7) Certificates of deposit received or shipped by respondent financial institution—including the following information:

(i) Name and address of issuer;

(ii) Date issued;

(iii) Dollar amount;

(iv) Name of registered holder;

(v) Due date;

(vi) Rate of interest;

(vii) Certificate number;

(viii) Name and address of issuing agent.

(c) *Scope of reports.* In issuing regulations as provided in paragraph (a) of this section, the Secretary will prescribe:

(1) A reasonable classification of financial institutions subject to or exempt from a reporting requirement;

(2) A foreign country to which a reporting requirement applies if the Secretary decides that applying the requirement to all foreign countries is unnecessary or undesirable;

(3) The magnitude of transactions subject to a reporting requirement; and

(4) The kind of transaction subject to or exempt from a reporting requirement.

(d) *Form of reports.* Regulations issued pursuant to paragraph (a) of this section may prescribe the manner in which the information is to be reported. However, the Secretary may authorize a designated financial institution to report in a different manner if the institution demonstrates to the Secretary that the form of the required report is unnecessarily burdensome on the institution as prescribed; that a report in a different form will provide all the information the Secretary deems necessary; and that submission of the information in a different manner will not unduly hinder the effective administration of this part.

(e) *Limitations.* (1) In issuing regulations under paragraph (a) of this section, the Secretary shall consider the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency.

(2) The Secretary shall not issue a regulation under paragraph (a) of this section for the purpose of obtaining individually identifiable account information concerning a customer, as defined by the Right to Financial Privacy Act (12 U.S.C. 3401 *et seq*.), where that customer is already the subject of an ongoing investigation for possible violation of the Currency and Foreign Transactions Reporting Act, or is known by the Secretary to be the subject of an investigation for possible violation of any other Federal law.

(3) The Secretary shall not issue a regulation pursuant to paragraph (a) of this section requiring a financial institution to report transactions that were both completed and reflected in its records prior to the date it received notice of the reporting requirement.

(Approved by the Office of Management and Budget under Control No. 1505-0063)

§103.26 Filing of reports.

(a) A report required to be filed by paragraph (a)(1) or (a)(2) of § 103.22 shall be filed within 15 days following the day on which the transaction occurred. The reports shall be filed with the Commissioner of Internal Revenue on forms to be prescribed by the Secretary. All information called for in such forms shall be furnished. A copy of each report shall be retained by the financial institution for a period of five years from the date of the report.

(b) Reports required to be filed by § 103.23(a) shall be filed at the time of entry into the United States or at the time of departure, mailing or shipping from the United States, unless otherwise directed or permitted by the Commissioner of Customs. They shall be filed with the Customs officer in charge at any Customs port of entry or departure, or as otherwise permitted or directed by the Commissioner of Customs. If the currency or other monetary instruments with respect to which a report is required do not accompany a person entering or departing from the United States, such reports may be filed by mail on or before the date of entry, departure, mailing or shipping, with the Commissioner of Customs, Attention: Currency Transportation Reports, Washington, D.C. 20226. They shall be on forms to be prescribed by the Secretary and all information called for in such forms shall be furnished.

(c) Reports required to be filed by § 103.23(b) shall be filed with the Commissioner of Customs within 30 days after receipt of the currency or other monetary instruments. They may be filed with the Customs officer in charge at any port of entry or departure, or by mail addressed to the Commissioner of Customs, Attention: Currency Transportation Reports, Washington, D.C. 20226. They shall be on forms to be prescribed by the Secretary and all information called for in such forms shall be furnished.

(d) Reports required to be filed by § 103.24 shall be filed on or before June 30 each calendar year with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year. They shall be filed with the Commissioner of Internal Revenue on forms to be prescribed by the Secretary and all information called for in such forms shall be furnished.

(e) Forms to be used in making the reports required by §§ 103.22 and 103.24 may be obtained from the Internal Revenue Service. Forms to be used in making the reports required by § 103.23 may be obtained from the U.S. Customs Service.

(The information collection requirements contained in paragraph (a) were approved by the Office of Management and Budget under control number 1505-0087)

[37 FR 6912, Apr. 5, 1972, as amended at 50 FR 5068, Feb. 6, 1985]

§103.27 Identification required.

Before effecting any transaction with respect to which a report is required under paragraph (a) of § 103.22, a financial institution shall verify and record the name and address of the individual presenting a transaction, as well as record the identity, account number, and the social security or taxpayer identification number, if any, of any person or entity for whose or which account such transaction is to be effected. Verification of the identity of an individual who indicates that he is an alien or is not a resident of the United States must be made by passport, alien identification card, or other official document evidencing nationality or residence. Verification of identity in any other case may be by examination of a document normally acceptable as a means of identification when cashing checks, for example, a driver's license or a credit card. In each instance, the method used in verifying the identity of the customer shall be recorded on the report.

[45 FR 37820, June 5, 1980]

Subpart C—Records Required To Be Maintained

§ 103.31 Determination by the Secretary.

The Secretary hereby determines that the records required to be kept by this subpart have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.

§ 103.32 Records to be made and retained by persons having financial interests in foreign financial accounts.

Records of accounts required by § 103.24 to be reported on a Federal income tax return shall be retained by each person having a financial interest in any such account. Such records shall contain the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period. Such records shall be retained for a period of 5 years and shall be kept at all times available for inspection as authorized by law. In the computation of the period of 5 years, there shall be disregarded any period beginning with a date on which the taxpayer is indicted or information instituted on account of the filing of a false or fraudulent Federal income tax return or failing to file a Federal income tax return, and ending with the date on which final disposition is made of the criminal proceeding.

§ 103.33 Records to be made and retained by financial institutions.

Each financial institution shall retain either the original or a microfilm or other copy or reproduction of each of the following:

(a) A record of each extension of credit in an amount in excess of $5,000, except an extension of credit secured by an interest in real property, which record shall contain the name and address of the person to whom the extension of credit is made, the amount thereof, the nature or purpose thereof, and the date thereof;

(b) A record of each advice, request, or instruction received regarding a transaction which results in the transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account, or place outside the United States;

(c) A record of each advice, request, or instruction given to another financial institution or other person located within or without the United States, regarding a transaction intended to result in the transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account or place outside the United States;

§ 103.34 Additional records to be made and retained by banks.

(a)(1) With respect to each certificate of deposit sold or redeemed after May 31, 1978, or each deposit or share account opened with a bank after June 30, 1972, a bank shall, within 45 days from the date such a transaction occurs or an account is opened, secure and maintain a record of the taxpayer identification number of the customer involved; or where the account or certificate is in the names of two or more persons, the bank shall secure the taxpayer identification number of a person having a financial interest in the certificate or account. In the event that a bank has been unable to secure, within the 45-day period specified, the required identification, it shall nevertheless not be deemed to be in violation of this section if (i) it has made a reasonable effort to secure such identification, and (ii) it maintains a list containing the names, addresses, and account numbers of those persons from whom it has been unable to secure such identification, and makes the names, addresses, and account numbers of those persons available to the Secretary as directed by him. A bank acting as an agent for another person in the purchase or redemption of a certificate of deposit issued by another bank is responsible for obtaining and recording the required taxpayer identification, as well as for maintaining the records referred to in paragraphs (b) (11) and (12) of this section. The issuing bank can satisfy the recordkeeping requirement by recording the name and address of the agent together with a description of the instrument and the date of the transaction.

(2) The 45-day period provided for in paragraph (a) (1) of this section shall be extended where the person opening the account has applied for a taxpayer identification or social security number on Form SS-4 or SS-5, until such time as the person maintaining the account has had a reasonable opportunity to secure such number and furnish it to the bank.

(3) A taxpayer identification number required under paragraph (a)(1) of this section need not be secured for accounts or transactions with the following: (i) Agencies and instrumentalities of Federal, State, local or foreign governments; (ii) judges, public officials, or clerks of courts of record as custodians of funds in controversy or under the control of the court; (iii) aliens who are (A) ambassadors, ministers, career diplomatic or consular officers, or (B) naval, military or other attaches of foreign embassies and legations, and for the members of their immediate families; (iv) aliens who are accredited representatives of international organizations which are entitled to enjoy privileges, exemptions and immunities as an international organization under the International Organization Immunities Act of December 29, 1945 (22 U.S.C. 288), and the members of their immediate families; (v) aliens temporariliy residing in the United States for a period not to exceed 180 days; (vi) aliens not engaged in a trade or business in the United States who are attending a recognized college or university or any training program, supervised or conducted by any agency of the Federal Government; (vii) unincorporated subordinate units of a tax exempt central organization which are covered by a group exemption letter, (viii) a person under 18 years of age with respect to an account opened as a part of a school thrift savings program, provided the annual interest is less than $10; (ix) a person opening a Christmas club, vacation club and similar installment savings programs provided the annual interest is less than $10; and (x) non-resident aliens who are not engaged in a trade or business in the United States. In instances described in paragraphs (a)(3), (viii) and (ix) of this section, the bank shall, within 15 days following the end of any calendar year in which the interest accrued in that year is $10 or more use its best effort to secure and maintain the appropriate taxpayer identification number or application form therefor.

(4) The rules and regulations issued by the Internal Revenue Service under section 6109 of the Internal Revenue Code of 1954 shall determine what constitutes a taxpayer identification number and whose number shall be obtained in the case of an account maintained by one or more persons.

(b) Each bank shall, in addition, retain either the original or a microfilm or other copy or reproduction of each of the following:

(1) Each document granting signature authority over each deposit or share account;

(2) Each statement, ledger card or other record on each deposit or share account, showing each transaction in, or with respect to, that account;

(3) Each check, clean draft, or money order drawn on the bank or issued and payable by it, except those drawn for $100 or less or those drawn on accounts which can be expected to have drawn on them an average of at least 100 checks per month over the calendar year or on each occasion on which such checks are issued, and which are (i) dividend checks, (ii) payroll checks, (iii) employee benefit checks, (iv) insurance claim checks, (v) medical benefit checks, (vi) checks drawn on government agency accounts, (vii) checks drawn by brokers or dealers in securities, (viii) checks drawn on fiduciary accounts, (ix) checks drawn on other financial institutions, or (x) pension or annuity checks;

(4) Each item in excess of $100 (other than bank charges or periodic charges made pursuant to agreement with the customer), comprising a debit to a customer's deposit or share account, not required to be kept, and not specifically exempted, under paragraph (b) (3) of this section;

(5) Each item, including checks, drafts, or transfers of credit, of more than $10,000 remitted or transferred to a person, account or place outside the United States;

(6) A record of each remittance or transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account or place outside the United States;

(7) Each check or draft in an amount in excess of $10,000 drawn on or issued by a foreign bank which the

domestic bank has paid or presented to a nonbank drawee for payment;

(8) Each item, including checks, drafts or transfers of credit, of more than $10,000 received directly and not through a domestic financial institution, by letter, cable or any other means, from a bank, broker or dealer in foreign exchange outside the United States;

(9) A record of each receipt of currency, other monetary instruments, investment securities or checks, and of each transfer of funds or credit, of more than $10,000 received on any one occasion directly and not through a domestic financial institution, from a bank, broker or dealer in foreign exchange outside the United States; and

(10) Records prepared or received by a bank in the ordinary course of business, which would be needed to reconstruct a demand deposit account and to trace a check in excess of $100 deposited in such account through its domestic processing system or to supply a description of a deposited check in excess of $100. This subparagraph shall be applicable only with respect to demand deposits.

(11) A record containing the name, address, and taxpayer identification number, if available, of the purchaser of each certificate of deposit, as well as a description of the instrument, a notation of the method of payment, and the date of the transaction.

(12) A record containing the name, address and taxpayer identification number, if available, of any person presenting a certificate of deposit for payment, as well as a description of the instrument and the date of the transaction.

[38 FR 2175, Jan. 22, 1973, as amended at 38 FR 3509, Feb. 7, 1973; 43 FR 21672, May 19, 1978]

§ 103.35 Additional records to be made and retained by brokers or dealers in securities.

(a)(1) With respect to each brokerage account opened with a broker or dealer in securities after June 30, 1972, by a person residing or doing business in the United States or a citizen of the United States, such broker or dealer shall within 45 days from the date such account is opened, secure and maintain a record of the taxpayer identification number of the person maintaining the account; or in the case of an account of one or more individuals, such broker or dealer shall secure and maintain a record of the social security number of an individual having a financial interest in that account. In the event that a broker or dealer has been unable to secure the identification required within the 45-day period specified, it shall nevertheless not be deemed to be in violation of this section if: (i) It has made a reasonable effort to secure such identification, and (ii) it maintains a list containing the names, addresses, and account numbers of those persons from whom it has been unable to secure such identification, and makes the names, addresses, and account numbers of those persons available to the Secretary as directed by him.

(2) The 45-day period provided for in paragraph (a)(1) of this section shall be extended where the person opening the account has applied for a taxpayer identification or social security number on Form SS-4 or SS-5, until such time as the person maintaining the account has had a reasonable opportunity to secure such number and furnish it to the broker or dealer.

(3) A taxpayer identification number for a deposit or share account required under paragraph (a)(1) of this section need not be secured in the following instances: (i) Accounts for public funds opened by agencies and instrumentalities of Federal, State, local, or foreign governments, (ii) accounts for aliens who are (*a*) ambassadors, ministers, career diplomatic or consular officers, or (*b*) naval, military or other attaches of foreign embassies, and legations, and for the members of their immediate families, (iii) accounts for aliens who are accredited representatives to international organizations which are entitled to enjoy privileges, exemptions, and immunities as an international organization under the International Organizations Immunities Act of December 29, 1945 (22 U.S.C. sec. 288), and for the members of their immediate families, (iv) aliens temporarily residing in the United States for a period not to exceed 180 days, (v) aliens not engaged in a trade

or business in the United States who are attending a recognized college or university or any training program, supervised or conducted by any agency of the Federal Government, and (vi) unincorporated subordinate units of a tax exempt central organization which are covered by a group exemption letter.

(b) Every broker or dealer in securities shall, in addition, retain either the original or a microfilm or other copy or reproduction of each of the following:

(1) Each document granting signature or trading authority over each customer's account;

(2) Each record described in § 240.17a-3(a) (1), (2), (3), (5), (6), (7), (8), and (9) of Title 17, Code of Federal Regulations;

(3) A record of each remittance or transfer of funds, or of currency, checks, other monetary instruments, investment securities, or credit, of more than $10,000 to a person, account, or place, outside the United States;

(4) A record of each receipt of currency, other monetary instruments, checks, or investment securities and of each transfer of funds or credit, of more than $10,000 received on any one occasion directly and not through a domestic financial institution, from any person, account or place outside the United States.

[37 FR 26518, Dec. 13, 1972, as amended at 38 FR 2176, Jan. 22, 1973]

§ 103.36 Additional records to be made and retained by casinos.

(a) With respect to each deposit of funds, account opened or line of credit extended after the effective date of these regulations, a casino shall, at the time the funds are deposited, the account is opened or credit is extended, secure and maintain a record of the social security number of the person involved. Where the deposit, account or credit is in the names of two or more persons, the casino shall secure the social security number of each person having a financial interest in the deposit, account or line of credit. In the event that a casino has been unable to secure the required social security number, it shall not be deemed to be in violation of this section if (1) it has made a reasonable effort to secure such number and (2) it maintains a list containing the names and permanent addresses of those persons from who it has been unable to obtain social security numbers and makes the names and addresses of those persons available to the Secretary upon request.

(b) In addition, each casino shall retain either the original or a microfilm or other copy or reproduction of each of the following:

(1) A record of each receipt (including but not limited to funds for safekeeping or front money) of funds by the casino for the account (credit or deposit) of any person. The record shall include the name, permanent address and social security number of the person from whom the funds were received, as well as the date and amount of the funds received. If the person from whom the funds were received is a non-resident alien, the person's passport number or a description of some other government document used to verify the person's identity shall be obtained and recorded;

(2) A record of each bookkeeping entry comprising a debit or credit to a customer's deposit account or credit account with the casino;

(3) Each statement, ledger card or other record of each deposit account or credit account with the casino, showing each transaction (including deposits, receipts, withdrawals, disbursements or transfers) in or with respect to, a customer's deposit account or credit account with the casino;

(4) A record of each extension of credit in excess of $2500, the terms and conditions of such extension of credit, and repayments. The record shall include the customer's name, permanent address, social security number, and the date and amount of the transaction (including repayments). If the customer or person for whom the credit extended is a non-resident alien, his passport number or description of some other government document used to verify his identity shall be obtained and recorded;

(5) A record of each advice, request or instruction received or given by the casino for itself or another person

with respect to a transaction involving a person, account or place outside the United States (including but not limited to communications by wire, letter, or telephone). If the transfer outside the United States is on behalf of a third party, the record shall include the third party's name, permanent address, social security number, signature, and the date and amount of the transaction. If the transfer is received from outside the United States on behalf of a third party, the record shall include the third party's name, permanent address, social security number, signature, and the date and amount of the transaction. If the person for whom the transaction is being made is a non-resident alien the record shall also include the person's name, his passport number or a description of some other government document used to verify his identity;

(6) Records prepared or received by the casino in the ordinary course of business which would be needed to reconstruct a person's deposit account or credit account with the casino or to trace a check deposited with the casino through the casino's records to the bank of deposit.

(7) All records, documents or manuals required to be maintained by a casino under state and local laws or regulations.

(Approved by the Office of Management and Budget under control number 1505-0087)

[50 FR 5068, Feb. 6, 1985]

§ 103.37 Nature of records and retention period.

(a) Wherever it is required that there be retained either the original or a microfilm or other copy or reproduction of a check, draft, monetary instrument, investment security, or other similar instrument, there shall be retained a copy of both front and back of each such instrument or document, except that no copy need be retained of the back of any instrument or document which is entirely blank or which contains only standardized printed information, a copy of which is on file.

(b) Records required by this subpart to be retained by financial institutions may be those made in the ordinary course of business by a financial institution. If no record is made in the ordinary course of business of any transaction with respect to which records are required to be retained by this subpart, then such a record shall be prepared in writing by the financial institution.

(c) Records which are required by § 103.34(b)(10) to be retained by banks shall be retained for a period of 2 years. All other records which are required by this subpart to be retained by financial institutions shall be retained for a period of 5 years. All such records shall be filed or stored in such a way as to be accessible within a reasonable period of time, taking into consideration the nature of the record, and the amount of time expired since the record was made.

[37 FR 6912, Apr. 5, 1972. Redesignated at 50 FR 5068, Feb. 6, 1985]

§ 103.38 Person outside the United States.

For the purposes of this subpart, a remittance or transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit to the domestic account of a person whose address is known by the person making the remittance or transfer, to be outside the United States, shall be deemed to be a remittance or transfer to a person outside the United States, except that, unless otherwise directed by the Secretary, this section shall not apply to a transaction on the books of a domestic financial institution involving the account of a customer of such institution whose address is within approximately 50 miles of the location of the institution, or who is known to be temporarily outside the United States.

[37 FR 6912, Apr. 5, 1972. Redesignated at 50 FR 5068, Feb. 6, 1985]

Subpart D—General Provisions

§ 103.41 Dollars as including foreign currency.

Wherever in this part an amount is stated in dollars, it shall be deemed to mean also the equivalent amount in any foreign currency.

§ 103.42 Photographic or other reproductions of Government obligations.

Nothing herein contained shall require or authorize the microfilming or other reproduction of

(a) Currency or other obligation or security of the United States as defined in 18 U.S.C. 8, or

(b) Any obligation or other security of any foreign government, the reproduction of which is prohibited by law.

§ 103.43 Availability of information.

(a) The Secretary may make any information set forth in any report received pursuant to this part available to any other department or agency of the United States, any state or local government or any foreign government, upon the request of the head of such department or agency made in writing and stating the particular information desired, the criminal, tax or regulatory investigation or proceeding in connection with which the information is sought and the official need therefor.

(b) The Secretary may make any information set forth in any report received pursuant to this part available to any other department or agency of the United States that is a member of the Intelligence Community, as defined by Executive Order 12356 or any succeeding executive order, upon the request of the head of such department or agency made in writing and stating the particular information desired, the national security matter with which the information is sought and the official need therefor.

(c) Any information made available under this section to other department or agencies of the United States, any state or local government, or any foreign government shall be received by them in confidence, and shall not be disclosed to any person except for official purposes relating to the investigation, proceeding or matter in connection with which the information is sought.

§ 103.44 Disclosure.

All reports required under this part and all records of such reports are specifically exempted from disclosure under section 552 of Title 5, United States Code.

§ 103.45 Exceptions, exemptions, and reports.

(a) The Secretary, in his sole discretion, may by written order or authorization make exceptions to or grant exemptions from the requirements of this part. Such exceptions or exemptions may be conditional or unconditional, may apply to particular persons or to classes of persons, and may apply to particular transactions or classes of transactions. They shall, however, be applicable only as expressly stated in the order of authorization, and they shall be revocable in the sole discretion of the Secretary.

(b) The Secretary shall have authority to further define all terms used herein.

(c) (1) The Secretary may, as an alternative to the reporting and recordkeeping requirements for casinos in §§ 103.22(a)(2) and 103.25(a)(2), and 103.36, grant exemptions to the casinos in any state whose regulatory system substantially meets the reporting and recordkeeping requirements of this part.

(2) In order for a state regulatory system to qualify for an exemption on behalf of its casinos, the state must provide:

(i) That the Treasury Department be allowed to evaluate the effectiveness of the state's regulatory system by periodic oversight review of that system;

(ii) That the reports required under the state's regulatory system be submitted to the Treasury Department within 15 days of receipt by the state.

(iii) That any records required to be maintained by the casinos relevant to any matter under this Part and to which the state has access or maintains under its regulatory system be made available to the Treasury Department within 30 days of request.

(iv) That the Treasury Department be provided with periodic status reports on the state's compliance efforts and findings;

(v) That all but minor violations of the state requirements be reported to Treasury within 15 days of discovery; and

(iv) That all but minor violations of the state requirements be reported to Treasury within 15 days of discovery; and

(vi) That the state will initiate compliance examinations of specific institutions at the request of Treasury within a reasonable time, not to exceed 90 days where appropriate, and will provide reports of these examinations to Treasury within 15 days of completion or periodically during the course of the examination upon the request of the Secretary. If for any reason the state were not able to conduct an investigation within a reasonable time, the state will permit Treasury to conduct the investigation.

(3) Revocation of any exemption under this subsection shall be in the sole discretion of the Secretary.

[38 FR 2176, Jan. 22, 1973, as amended at 50 FR 5068, Feb. 6, 1985]

§ 103.46 Enforcement.

(a) Responsibility for assuring compliance with the requirements of this part is delegated as follows:

(1) To the Comptroller of the Currency with respect to those financial institutions regularly examined for safety and soundness by national bank examiners;

(2) To the Board of Governors of the Federal Reserve System with respect to those financial institutions regularly examined for safety and soundness by Federal Reserve bank examiners;

(3) To the Federal Deposit Insurance Corporation with respect to those financial institutions regularly examined for safety and soundness by FDIC bank examiners;

(4) To the Federal Home Loan Bank Board with respect to those financial institutions regularly examined for safety and soundness by FHLBB bank examiners;

(5) To the Administrator of the National Credit Union Administration with respect to those financial institutions regularly examined for safety and soundness by NCUA examiners;

(6) To the Securities and Exchange Commission with respect to brokers or dealers in securities;

(7) To the Commissioner of Customs with respect to §§ 103.23 and 103.48;

(8) To the Commissioner of Internal Revenue except as otherwise specified in this section.

(b) Overall responsibility for coordinating the procedures and efforts of the agencies listed herein and assuring compliance with this part is delegated to the Assistant Secretary (Enforcement and Operations). Periodic reports shall be made by each such agency to the Assistant Secretary (Enforcement and Operations), with copies to the General Counsel of the Treasury and to the Commissioner of Internal Revenue.

(Sec. 21, Federal Deposit Insurance Act, 84 Stat. 1114, 12 U.S.C. 1829b; 84 Stat. 1116, 12 U.S.C. 1951-1959, and the Currency and Foreign Transactions Reporting Act, 84 Stat. 1118, 31 U.S.C. 1051-1122)

[37 FR 6912, Apr. 5, 1972, as amended at 42 FR 33033, June 29, 1977; 44 FR 13478, Mar. 12, 1979]

§ 103.47 Civil penalty.

(a) For any willful violation of any requirement of this part, the Secretary may assess upon any domestic financial institution, and upon any partner, director, officer or employee thereof who willfully participates in the violation, a civil penalty not exceeding $10,000.

(b) For any failure to file a report required under § 103.23 or for filing such a report containing any material omission or misstatement, the Secretary may assess a civil penalty up to the amount of the currency or monetary instruments transported, mailed or shipped, less any amount forfeited under § 103.48.

[37 FR 6912, Apr. 5, 1972, as amended at 50 FR 18479, May 1, 1985]

§ 103.48 Forfeiture of currency or monetary instruments.

Any currency or other monetary instruments which are in the process of any transportation with respect to which a report is required under § 103.23 are subject to seizure and forfeiture to the United States if such report has not been filed as required in § 103.25, or contains material omissions or misstatements. The Secretary may, in his sole discretion, remit or mitigate any such forfeiture in whole or in part upon such terms and conditions as he deems reasonable.

§ 103.49 Criminal penalty.

(a) Any person who willfully violates any provision of title I of Pub. L. 91-508, or of this part authorized thereby may, upon conviction thereof, be fined not more than $1,000 or be imprisoned not more than 1 year, or both. Such person may in addition, if the violation is of any provision authorized by title I of Pub. L. 91-508 and if the violation is committed in furtherance of the commission of any violation of Federal law punishable by imprisonment for more than 1 year, be fined not more than $10,000 or be imprisoned not more than 5 years, or both.

(b) Any person who willfully violates any provision of title II of Pub. L. 91-508, or of this part authorized thereby, may, upon conviction thereof, be fined not more than $250,000 or be imprisoned not more than 5 years, or both.

(c) Any person who willfully violates any provision of title II of Pub. L. 91-508, or of this part authorized thereby, where the violation is either

(1) Committed in furtherance of the commission of any other violation of Federal law, or

(2) Committed as part of a pattern of illegal activity involving transactions exceeding $100,000 in any 12-month period, may, upon conviction thereof, be fined not more than $500,000 or be imprisoned not more than 5 years, or both.

(d) Any person who knowingly makes any false, fictitious or fraudulent statement or representation in any report required by this part may, upon conviction thereof, be fined not more than $10,000 or be imprisoned not more than 5 years, or both.

[37 FR 6912, Apr. 5, 1972, as amended at 50 FR 18479, May 1, 1985]

§ 103.50 Enforcement authority with respect to transportation of currency or monetary instruments.

(a) If a customs officer has reasonable cause to believe that there is a monetary instrument being transported without the filing of the report required by §§ 103.23 and 103.25 of this chapter, he may stop and search, without a search warrant, a vehicle, vessel, aircraft, or other conveyance, envelope or other container, or person entering or departing from the United States with respect to which or whom the officer reasonably believes is transporting such instrument.

(b) If the Secretary has reason to believe that currency or monetary instruments are in the process of transportation and with respect to which a report required under § 103.23 has not been filed or contains material omissions or misstatements, he may apply to any court of competent jurisdiction for a search warrant. Upon a showing of probable cause, the court may issue a warrant authorizing the search of any or all of the following:

(1) One or more designated persons.

(2) One or more designated or described places or premises.

(3) One or more designated or described letters, parcels, packages, or other physical objects.

(4) One or more designated or described vehicles. Any application for a search warrant pursuant to this section shall be accompanied by allegations of fact supporting the application.

(c) This section is not in derogation of the authority of the Secretary under any other law or regulation.

[37 FR 6912, Apr. 5, 1972, as amended at 50 FR 18479, May 1, 1985]

§ 103.51 Access to records.

Except as provided in §§ 103.34(a)(1), 103.35(a)(1), and 103.36(a) and except for the purpose of assuring compliance with the recordkeeping and reporting requirements of this part, this part does not authorize the Secretary or any other person to inspect or review the records required to be maintained by Subpart C of this part. Other inspection, review or access to such records is governed by other applicable law.

[50 FR 5068, Feb. 6, 1985]

§ 103.52 Rewards for informants.

(a) If an individual provides original information which leads to a recovery of a criminal fine, civil penalty, or forfeiture, which exceeds $50,000, for a violation of the provisions of the Act or of this part, the Secretary may pay a reward to that individual.

(b) The Secretary shall determine the amount of the reward to be paid under this section; however, any reward paid may not be more than 25 percent of the net amount of the fine, penalty or forfeiture collected, or $150,000, whichever is less.

(c) An officer or employee of the United States, a State, or a local government who provides original information described in paragraph (a) in the performance of official duties is not eligible for a reward under this section.

[50 FR 18479, May 1, 1985]

APPENDIX—INTERPRETATIONS AND EXEMPTIONS

The following interpretations and exemptions were compiled in response to requests by persons subject to the regulations of Part 103. Additional interpretations and exemptions will appear from time to time as the occasion warrants. Identifying details and confidential information have been deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements concerning disclosure of information obtained from members of the public.

Section 103.11 *Exemption from.* 1. The definition of a bank as appears in § 103.11 (a)(7) was not intended to include a company which is wholly engaged in financing inventories and retail installment sales of automobile dealers. Such a company requested and was granted an exemption from the recordkeeping and reporting requirements of Part 103, Title 31, Code of Federal Regulations. However, if said company is a "financial institution" within the meaning of § 103.11 (other than as a "bank") it would, of course, have to comply with those provisions of this part relating to financial institutions other than banks.

Section 103.23 *Interpretations.* 1. Unless a transaction in foreign currency for clients who are nonresidents of the United States and performed through brokers outside the United States involves the physical transportation, mailing, or shipment of currency, bearer investment securities or negotiable instruments in bearer form into or out of the United States in amounts exceeding $5,000 on any one occasion, there is no duty to report the transfer. A transfer of funds by means of bank check, bank draft, or wire transfer need not be reported.

2. A bank is not required to prepare Form 4790 if the bank receives such items over the counter from a person who may have transported them into the United States or if the bank delivers such items over the counter to a person who may transport them out of the United States. However, if a bank knows that such items have been transported into the country, it must file a report on Form 4790 if a complete and truthful report has not been filed by the customer.

3. Section 103.23(c) provides that a bank is not required to report currency or other monetary instruments mailed or shipped through the postal service or by common carrier. When a trust company is acting as a corporate executor or corporate trustee, no report need be filed with respect to currency or bearer monetary instruments mailed or shipped through the postal service.

4. In the case where a trust company acts as custodian for individual executors and trustees who maintain custody accounts for those estates and trusts where they are named fiduciary, it will be necessary to file a Form 4790, Report of International Transportation of Currency or Monetary Instruments, under the circumstances described in § 103.23(a).

5. A private courier service does not qualify as a "common carrier" under the regulations.

Section 103.23 *Exemptions from.* 1. A bank whose employees physically transport currency across the Canadian border on a weekly basis for deposit with a Canadian bank which is only a few hundred yards away requested an exemption from the requirements of § 103.23. Due to the special circumstances, the Department granted the request provided that an accurate record of such transfers is maintained by the bank.

2. A bank in Maine, which for a period of more than 20 years, has used its personnel to physically transport sums of currency and checks in excess of $5,000 to and from a bank in a contiguous Canadian town several times a month, requested and was granted an exemption from the reporting requirements of § 103.23 due to the special circumstances involved. The Department, however, does require the bank to maintain an accurate account of such transfers.

3. An exemption is granted to any merchant shipping company from the requirement to report the transportation into or out of the United States of currency or bearer instruments in amounts in excess of $5,000 with respect to currency or bearer instruments placed on board ship by the owner or operator in order to provide for reasonable shipping needs. Records of such moneys placed on board are to be maintained by the shipping companies.

4. A company that transports sealed packages containing money and valuables under written bilateral contracts for banks, brokerage houses, and security dealers requested an exemption from the requirements of this section. Under the provisions of § 103.23(c)(7), such companies are exempt from reporting the transportation of currency or monetary instruments overland between established offices of banks or brokers or dealers in securities and foreign banks. The company in question is further granted an exemption from reporting overland shipments between domestic banks, brokers, or security dealers and foreign persons. However, all firms engaged in international carriage of valuables by air must continue to file with the Bureau of Customs reports of international air shipments.

SECTION 103.24 *Interpretation.* Treasury announced on March 20, 1978, that an officer or employee of a domestic corporation, which has securities listed on national securities exchanges or which has assets exceeding $1 million and 500 or more shareholders of record, need not report that he has signature authority over a foreign financial account of the corporation, provided he has no personal financial interest in the account and has been advised in writing by the chief financial officer of the corporation that the corporation has filed a current report which includes that account.

Treasury subsequently received a request for an interpretation regarding the ruling's applicability to officers and employees of domestic subsidiaries of such corporations.

Since the March 30 notice permits a parent corporation to file a consolidated report of foreign financial accounts on behalf of itself and any other entity in which it owns directly or indirectly more than a 50 percent interest, we see no reason to discriminate between employees of the parent and those of its subsidiaries.

Accordingly, an officer or employee of a domestic subsidiary of a domestic corporation which has securities listed on national securities exchanges or which has assets exceeding $1 million and 500 or more shareholders of record, need not report that he has signature authority over a foreign financial account of the subsidiary, if he has no personal financial interest in the account and has been advised in writing by the chief financial officer of the parent corporation that the subsidiary corporation has filed a current report which includes that account.

Section 103.33(a) *Interpretation.* 1. This regulation requires the keeping of records, the majority of which are already kept by financial institutions. The typical loan application form asks the applicant to state the purpose of the loan, so it would seem normal in the case of each extension of credit in an amount in excess of $5,000 for the record to contain a reference to the nature or the purpose of the loan. However, if it is a passbook loan, for example, the entry "passbook loan" would suffice.

Section 103.34(a) *Interpretations.* 1. Any citizen residing or doing business in the United States and any citizen of the United States who opens an account with a financial institution after June 30, 1972, must provide that institution with his taxpayer identification number at the time the account is opened. For individuals, the taxpayer identification number is his social security number; for corporations, partnerships, and other entities, it is the IRS employer identification number.

Banks, savings and loan associations, building and loan associations, savings banks, credit unions, and brokers and dealers in securities are included in this requirement. If an account is opened in more than one individual's name, the financial institution is required to secure and maintain the social security number of at least one individual having a financial interest in that account.

If the customer does not have a taxpayer identification number or has lost his card and is unaware of his number, the account may be opened provided the customer (or if under 18 years of age, his guardian) authorizes the Social Security Administration to furnish his social security number to both the customer and the financial institution, or the customer, regardless of age, authorizes the Internal Revenue Service to furnish his employer identification number to both the customer and the financial institution.

With respect to accounts opened for trusts, charitable organizations, clubs, and similar entities the financial institution should secure the employer identification number of the entity. An employer identification number must be obtained for this purpose even though an organization might not otherwise require one. See instructions published July 6, 1972 (37 FR 13279).

2. This requirement of a taxpayer identification number does not apply to aliens who are ambassadors, ministers, career diplomatic or consular officers, or to naval, military and other attaches of foreign embassies and legations, and the members of their immediate families, nor to aliens who are accredited representatives to international organizations entitled to enjoy privileges, exemptions, and immunities as an international organization under the International Organizations Immunities Act of December 29, 1945 (22 U.S.C. 288), and the members of their immediate families.

3. In regard to determining the proper identifying number to be furnished by accounts opened in more than one name, the bank should follow the regulations and rulings issued by the Internal Revenue Service under section 6109 of the Internal Revenue Code. These rules are outlined on the back of IRS Form 3435. However, the bank should not use Form 3435 to apply for a taxpayer identification number for a new account, but should instead use Form SS-4 or SS-5.

4. The bankruptcy estate of an individual or partnership is considered as a separate entity from the individual or partnership. However, the Treasury Department does not regard the estate of a corporation in bankruptcy as an entity separate from the corporation. Accordingly, the trustee of a corporation in bankruptcy should use the identification number of the corporation. Upon completion of the IRS Form SS-4 with an appropriate authorization to furnish the employer identification number to the institution, a trustee will be permitted to make deposits. He need not wait until the employer identification number is obtained.

5. All accounts that are primarily savings or checking accounts, with the exception of

mortgage escrow accounts, are deposit accounts and are subject to the requirements of this section.

6. Where a person purchases a money order directly from the bank or through an agent of the bank and the bank maintains only a consolidated account with no separate record by customer, no deposit account has been opened by the customer and only those recordkeeping requirements normally applicable to cashier's checks would apply.

7. Where a person reopens a checking account after June 30, 1972, the bank is required to secure the social security number just as with a new account, and the same would apply to the automatic extension of a certificate of deposit.

8. (Reserved)

9. A credit card program operated by a bank does not involve a deposit account and is not, therefore, subject to the requirements of this section.

10. Section 103.34(a) exempts nonresident aliens not doing business in the United States from the requirement to furnish the bank with a taxpayer identification number. If an alien asserts that he is neither residing nor doing business in the United States a bank therefor may open the account without obtaining a taxpayer identification number, provided that it secures a statement from the person to that effect and provided the bank is unaware of any facts inconsistent with that statement. Normal banking practices for ascertaining identity and location of customers should be followed. All nonresident aliens in the United States should have one of the following U.S. Immigration and Naturalization Service forms:

1. Form I-151 (Alien Registration Receipt Card).
2. Form I-185 (Nonresident Alien Canadian Border Crossing Card).
3. Form I-186 (Nonresident Alien Mexican Border Crossing Card).
4. Form I-94 (Arrival-Departure Record).
5. Form I-95A (Alien Crewman's Landing Permit).
6. Form I-184 (Alien Crewman's Landing Permit and Identification Card).

The bank should maintain a record of the applicant's country of citizenship and the number assigned him on his INS form or other official document issued by the applicant's government.

11. In regard to a business firm opening an account in the name of employees who are foreign nationals not residing in the United States, the bank may open the account for them without securing a taxpayer identification number pursuant to this section provided that the bank is satisfied that the persons are nonresident aliens not doing business in the United States. The bank should verify the identity and whereabouts of such persons and require the business firm to supply for each such account a statement to the effect that the employee is a nonresident alien not doing business in the United States.

12. It is acknowledged that the "Old Order Amish" people do not accept social security benefits or pay self-employment tax. In 1965, the Internal Revenue Code was amended to provide an exemption from self-employment tax if a person can shown that he is a member of a recognized religious sect which follows the practice of making reasonable provisions for its dependent members. While the Amish people are opposed to and exempted from the social security program, they do pay their Federal taxes. A bank should explain to its Amish customers that the number required to open any account is merely a taxpayer identification number and in no way obligates such person to the social security system. However, if a depositor still objects on religious grounds to applying for a social security number, Form SS-4, Application for an Employer Identification Number, can be used instead.

13. If a new business has applied for an employer identification number, but has not yet received it when it seeks to open a bank account, the bank may open the account if it secures a completed Form SS-4 in accordance with the instructions issued by Treasury. The completed Form should not be sent to IRS but simply retained as evidence that an application for a number is pending. Since in the above instance the bank will not automatically receive the number, it must follow up with the customer to insure that the number is furnished within a reasonable time. Generally speaking, the Internal Revenue Service furnishes an employer identification number to an applicant within 45 days.

Section 103.34(a) *Exemptions from.* 1. An exemption from the requirements of this subsection is granted with respect to all accounts opened as part of a school savings program for school savers up to 18 years of age, provided that the amount of interest earned on such accounts is $10 or less. Children over 18 years of age may apply for a social security number without parental authorization and payments of interest aggregating $10 or more are required by section 6049, Internal Revenue Code of 1954, to be reported on Form 1099, together with the depositor's social security number. Banks having a school savings program should set up appropriate procedures to obtain numbers for accounts held by persons aged 18 years or older and for all accounts earning interest of $10 or more annually. 2. An exemption from the requirements of this subsection is granted with respect to Christmas Club accounts, provided the annual interest is not anticipated to exceed $10.

Section 103.34(b) *Interpretations.* 1. If there is no check or draft corresponding to a preauthorized paper entry, it will be sufficient to maintain the customer's authorization to charge his account and the memorandum list of entries for a period of 5 years.

2. Insurance companies commonly issue drafts in settlement of claims or for other purposes which are payable through a particular bank, but which are drawn on the company itself and not on a deposit account. However, drafts which are issued by insurance companies are treated as checks throughout the financial system, despite the fact that they are not drawn on a deposit account, and are, therefore, subject to the requirements of § 103.34(b) (3). If these drafts meet the volume and purpose requirements of this section, no copy need be retained. If they do not meet these standards, it will be necessary for the bank to retain a copy of the draft as required by this section and to retain the records required by § 103.34(b) (10) for a period of 2 years.

3. Clean drafts, including "cash item drafts", are drawn "payable through" or "payable at" a particular bank. The bank receives them and presents them to its customer who reviews them and pays for those it accepts. The majority of such items should be eligible for exemption under § 103.34(b) (3), those which are not eligible should be microfilmed or copied before they are released to the customer.

4. Section 103.34(b) (10) does not require a receiving bank to copy or be able to produce an item drawn on another bank. Furthermore, a bank need not be able to supply a description of a deposited check if it can trace a check through its domestic processing system.

Section 103.36 *Interpretation.* 1. A bank must retain for a period of 5 years checks drawn on itself. However, the proof and entry run tapes, which allow a bank to reconstruct an account, need only be retained for a period of 2 years.

Section 103.37 *Interpretation.* 1. The term "temporarily" used in this section should be interpreted as a vacation or business assignment expected to last less than 6 months.

Section 103.42 *Interpretation.* 1. This section provides that nothing contained herein shall require or authorize the microfilming or other reproduction of currency or obligation or security of the United States as defined in 18 U.S.C. 8 or any obligation or security of any foreign government. However, government checks may be microfilmed, but not copied, for the purpose of tracing or identifying a transaction.

Section 103.45 *Exemptions.* 1. A bank, whose employees physically transport currency across the Canadian border on a weekly basis for deposit with a Canadian bank which is only a few hundred yards away, requested an exemption from the requirements of § 103.23. Due to the special circumstances, the Department granted the request provided that an accurate record of such transfers is maintained by the bank.

2. A bank in Maine, which for a period of more than 20 years has used its personnel to physically transport sums of currency and checks in excess of $5,000 to and from a bank in a contiguous Canadian town several times a month, requested and was granted an exemption from the reporting requirements of § 103.23 due to the special circumstances involved. The Department, however, does require the bank to maintain an accurate record of such transfers.

3. An exemption is granted to any merchant shipping company from the requirement to report the transportation into or out of the United States of currency or bearer instruments in amounts in excess of $5,000 with respect to currency or bearer instruments placed on board ship by the owner or operator in order to provide for reasonable shipping needs. Records of such monies placed on board are to be maintained by the shipping companies.

4. A company wholly engaged in financing inventories and retail installment sales of automobile dealers which came within the definition of a "bank" in § 103.11(a) (7) requested and was granted an exemption from the recordkeeping and reporting requirements of Part 103, Title 31, Code of Federal Regulations. However, if said company is a "financial institution" within the meaning of § 103.11 (other than as a "bank") it would, of course, have to comply with those provisions of this part relating to financial institutions other than banks.

5. An exemption from the requirements of § 103.34(a) is granted with respect to all accounts opened as part of a school savings program for school savers up to 18 years of age, provided that the amount of interest earned on such accounts is $10 or less. Children over 18 years of age may apply for a social security number without parental authorization and payments of interest aggregating $10 or more are required by section 6049, Internal Revenue Code of 1954, to be reported on Form 1099, together with the depositor's social security number. Banks having a school savings program should set up appropriate procedures to obtain numbers for accounts held by persons aged 18 years or older and for all accounts earning interest of $10 or more annually.

6. An exemption from the provisions of Part 103, Title 31, Code of Federal Regulations, is granted to those persons who are registered with the Securities and Exchange Commission as broker-dealers solely in order to offer and sell variable annuity contracts issued by life insurance companies.

Department of the Treasury
Internal Revenue Service
Publication 1148 (Rev. 4-83)

Currency Transaction Reporting Requirements and Instructions for Completing Form 4789, Currency Transaction Report (31 C.F.R. Part 103)

When any person engages with a financial institution in a currency transaction of more than $10,000, the financial institution must record the identity of the person or persons involved and file a report with the Internal Revenue Service within 15 days.

This requirements arises out of the Currency and Foreign Transactions Reporting Act which was enacted as Title II of Public Law 91-508. Regulations were adopted on April 5, 1972, with an effective date of July 1, 1972 (37 F.R. 6912 (1972)). These requirements were revised effective July 7, 1980 (45 F.R. 37818 (1980)).

Various provisions of the regulations are summarized below. For the full text of the regulations, see Part 103 of Title 31, Code of Federal Regulations.

Who Must File
(31 C.F.R. section 103.22(a))

Every financial institution must file a report of each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or to that financial institution, that involves a transaction in currency of more than $10,000. The reports must be made on forms prescribed by the Secretary, and all information called for in the forms must be given.

Reporting Form to be Used
(31 C.F.R. section 103.25(a))

The Secretary has prescribed Form 4789, Currency Transaction Report, to make the required report.

Reports of Certain Transactions not Required
(31 C.F.R. section 103.22(b)(1))

Except as otherwise directed in writing by the Assistant Secretary of the Treasury (Enforcement and Operations), this section shall not: (1) require reports of transactions with Federal Reserve Banks or Federal Home Loan banks; (2) require reports of transactions between domestic banks; or (3) require reports by nonbank financial institutions of transactions with commercial banks.

Exemptions to the Reporting Requirements
(31 C.F.R. sections 103.22(b)(2), (c), and (f))

Except as otherwise directed in writing by the Assistant Secretary (Enforcement and Operations), a bank may exempt from the reporting requirement of this section the following:

1. Deposits or withdrawals of currency from an existing account by an established depositor who is a United States resident and operates a retail type of business in the United States. For the purpose of this subsection, a retail type of business is a business primarily engaged in providing goods to ultimate consumers and for which the business is paid in substantial portion by currency, except that dealerships which provide automobiles, boats or airplanes are not included and their transactions are not exempt from the reporting requirement of this section.
2. Deposits or withdrawals of currency from an existing account by an established depositor who is a United States resident and operates a sports arena, race track, amusement park, bar, restaurant, hotel, check cashing service licensed by state or local governments, vending machine company, or theater.
3. Deposits, or withdrawals, exchanges of currency or other payments and transfers by local or state governments, or the United States or any of its agencies or instrumentalities.
4. Withdrawals for payroll purposes from an existing account by an established depositor who is a United States resident and operates a firm that regularly withdraws more than $10,000 in order to pay its employees in currency.

No other types of businesses may be exempted from the reporting requirements except for those shown in (1) through (4) above, unless authorized in writing by the Assistant Secretary (Enforcement and Operations). If a bank believes that circumstances warrant an exemption not provided for above, the banks may apply for approval of an exemption by writing to

Exemption Staff
Room 1134
Office of Enforcement and Operations
Department of Treasury
Washington, D.C. 20220.

In each instance where a transaction is exempted (1. through 4. above), the transaction must be in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the lawful, domestic business of that customer, or in the case of transactions with a local or state government or the United States or any of its agencies or instrumentalities, in amounts which are customary and commensurate with the authorized activities of the agency or instrumentality. This section does not permit a bank to exempt its transactions with a nonbank financial institution. (See Definitions, sections 1(h) through (k) for descriptions of nonbank financial institutions.)

Banks must maintain a record of each exemption granted. The record must include the name, address, type of business, taxpayer identification number and account number of the customer. The record must also specify the type of transaction(s) exempted and the dollar limit of each type of exemption. When requested by the Assistant Secretary (Enforcement and Operations), a bank shall provide, within 30 days, a report of all exempted customers. The report must include all of the above information for each customer.

Where to Get Form 4789
(31 C.F.R. section 103.25(d))

You can get the form from most Internal Revenue Service district offices.

When and Where to File
(31 C.F.R. section 103.25(a))

Form 4789 is due by the 15th day after the date the transaction occurred and should be mailed to the Internal Revenue Service Center, Ogden, UT 84201, or hand carried to your local IRS office.

Identification Required
(31 C.F.R. section 103.28)

Before completing any transaction for which a report is required, the financial institution must verify and record the name and address of the person making the transaction and the identity, account number, and any taxpayer identifying number of the person for whose account the transaction is to be effected. The identity of aliens must be verified by passport, alien identification card, or other official document showing foreign nationality or residence. In other cases, identity may be verified by a document normally acceptable as identification when cashing checks, for example, a driver's license or credit card. In each instance, the method used to verify the identity of the customer must be recorded on the report.

Definitions
(31 C.F.R. sections 103.11 and 103.41)

1. **Financial Institution**—Each agency, branch, or office within the United States of any person doing business in one or more of the capacities listed below.

   a. a commercial bank or trust company organized under the laws of any State or of the United States;

   b. a private bank;

   c. a savings and loan association or a building and loan association organized under the laws of any State or of the United States;

   d. an insured institution as defined in section 401 of the National Housing Act;

   e. a saving bank, industrial bank or other thrift institution;

   f. a credit union organized under the laws of any State or of the United States;

g. any other organization chartered under the banking laws of any State and subject to the supervision of the bank's supervisory authorities of a State.

h. a person who engages as a business in dealing in or exchanging currency as, for example, a dealer in foreign exchange or a person engaged primarily in the cashing of checks.

i. a person who engages as a business in the issuing, selling or redeeming of traveler's checks, money orders, or similar instruments, except one who does so as a selling agent exclusively, or as an incidental part of another business;

j. a licensed transmitter of funds, or other person engaged in the business of transmitting funds abroad for others.

k. a broker or dealer in securities;

l. each agent, agency, branch or office within the United States of a foreign bank.

2. **Currency**—The coin and currency of the United States or of any other country, which circulate in and are customarily used and accepted as money in the country in which issued. It includes United States silver certificates, United States notes and Federal Reserve notes, but does not include bank checks or other negotiable instruments not customarily accepted as money.

3. **Person**—An individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, and all entities cognizable as legal personalities.

4. **Transaction in Currency**—A transaction involving the physical transfer of currency from one person to another. A transaction in currency does not include a transfer of funds by means of bank check, bank draft, wire transfer, or other written order that does not include the physical transfer of currency.

5. **$10,000**—An amount stated in United States dollars also means the equivalent in any foreign currency.

6. **United States**—The various States, the District of Columbia, the Commonwealth of Puerto Rico, and the territories and possessions of the United States.

Penalties

(31 C.F.R. sections 103.47 and 103.49)

Civil penalties not to exceed $1,000 are provided for each currency transaction report not filed or for each incomplete or inaccurate report filed. Financial institutions and their employees may be also subject to criminal prosection for willful failure to comply with the recordkeeping and reporting requirements, or for willfully submitting a report that contains false or misleading information. Depending on the gravity of the offense, criminal penalties may range from imprisonment of up to 5 years, a fine of up to $500,000, or both, for each offense. Currency transaction reports are useful in discovering offenses that may have been committed against the United States. Attempts to circumvent required filings may be construed as aiding and abetting such offenses.

Supplemental Instructions for Completing Form 4789 Currency Transaction Report

(The item number below corresponds to the circled number on the exhibit Form 4789)

1. For all currency transactions except mail or night deposits, Part I must be completed. Enter the full name, permanent address (including ZIP code), and social security number (000-00-0000) of the individual who entered the financial institution to conduct the transaction. (Enter P.O. Box number(s) after the street address.) For armored car services licensed by a state or local government, provide only the name and address of the armored car service company. All other couriers or messengers must be fully identified. For mail or night deposits, write in "U.S. Mail" or "Night Deposit" in Part I and check the appropriate box in Part IV.

1a. The business, occupation, or profession of the individual who entered the financial institution to conduct the transaction in currency should be shown, for example, secretary, carpenter, attorney, etc. (Do not use nondescriptive terms, such as "self-employed", "merchant", "businessman", etc.)

2. If the individual is nonresident alien, or has no U.S. address, enter his or her complete foreign address, including country. If the individual has no social security number, enter "NONE" in the block for social security number.

3. All individuals (except employees of armored car services) conducting a currency transaction for themselves or for another person, must be positively identified. For U.S. citizens, a driver's permit or any other written identification document acceptable to the financial institution in normal check cashing operations must be requested and inspected, and the identification number recorded in this part. For an alien, his or her passport, alien ID card, or other official document showing nationality or residence must be inspected. It is necessary that the identifying data be recorded on the form in the "Method of verifying identification" section of Part I.

4. If the individual in Part I is conducting the currency transaction for himself or herself, do not complete Part II. In all other cases, including mail or night deposit transactions, enter in the appropriate boxes of Part II the full legal name, permanent address (including ZIP code), and taxpayer identification number of the individual or organization for whom the currency transaction is being conducted. Enter only the social security number (000-00-0000) of the individual or Federal employer's identification number (00-0000000) of the organization in the identification number box. If the individual or organization is foreign and has no social security or employer's identification number, enter "NONE" in the box for identifying number.

4a. The business, occupation, or profession of the individual or organization for whom the currency transaction is being conducted should be fully identified, for example, securities broker, law firm, auto dealer. (Do not use nondescriptive terms, such as "self-employed", "merchant", "businessman", etc.)

5. Enter the specific account number of the person in Part I or Part II who is involved in the currency transaction. If a deposit or withdrawal is made from a savings, checking, share, or other account, check the appropriate box and enter the account number. If the currency transaction involves a loan, enter the loan account number. "Other" accounts would include all accounts with broker-dealers. If the transaction is conducted by an individual or organization who is not a customer of the financial institution, enter "NONE" in the "OTHER" box of Part III.

6. Indicate the nature of the transaction by checking the appropriate box in Part IV, item 1. "OTHER" transactions in item 1 would include, but are not limited to, loan payments or loan proceeds in currency, securities purchases with currency, purchase or redemption of certificates of deposit with currency, currency presented or paid out in connection with a wire transfer of funds, and multiple transactions (see Multiple Transactions Instructions below). "Currency Exchange" transactions would include exchanging or purchasing U.S. currency with foreign currency and vice versa, and the exchange of small denomination bills of U.S. currency for other large denomination bills of U.S. currency, or vice versa. If a check was involved, see instruction number (11).

6a. Transactions with foreign financial institutions involving the purchase or sale of U.S. currency by domestic financial institutions should be reported in Part IV, item 1 as deposits (for purchases) and withdrawals (for sales) regardless of the nature of the underlying account relationship or the method of payment.

7. Enter the total amount of the currency transaction in U.S. dollars in item 2 of Part IV. If a deposit transaction includes both checks and currency, enter only the amount of the transaction that is in currency. If all or part of the currency is in foreign currency, enter the amount in equivalent U.S. dollars. (See General Instructions below regarding more than one foreign currency in the same transaction.)

8. Enter in item 3 of Part IV the total amount of the currency transaction that includes denominations in U.S. currency of $100 or higher. For example, if the total amount of the currency transaction is $100,000 and $50,000 is in U.S. currency of $100 or higher denominations, enter $100,000 in item 2 and $50,000 in item 3.

9. Enter the month, day, and year of the currency transaction in item 4 of Part IV.

10. If the currency transaction involves a foreign currency, enter the information in the appropriate boxes provided in item 5 of Part IV. (See General Instructions for more than one foreign currency in the same transaction.)

11. If the currency transaction involved the cashing or purchase of a check, enter the details in the appropriate boxes in item 6 of Part IV. (See General Instructions for more than one purchased or cashed check in the same transaction.)

12. Enter the full legal name, street address, city, state, ZIP code, and social security or employer's identification number of the financial institution where the currency transaction is conducted. If a branch office, enter the complete street address of the branch office. Enter P.O. Box number(s) below the street address. Enter your type of financial institution under "Business Activity". (See Definitions section for types of financial institutions.)

13. Form 4789 must be signed by an individual authorized or designated by the financial institution to sign it. His or her title should be indicated and the date of signature entered. This signer's name should be typed or printed legibly below the signature.

General Instructions

If you need more space to explain any entry or to provide additional information regarding a currency transaction, use a separate sheet of paper that clearly identifies the person for whom the transaction was conducted. Indicate the part number and specific item of Form 4789 that relates to the additional information provided.

If a series of checks are cashed or purchased in the same transaction, itemize the transaction on a separate sheet of paper providing the details of each check as required in item 6 of Part IV. Enter the total of the checks in the "amount of check" box and the word "various" in other appropriate boxes in item 6.

If currency of two or more foreign countries is involved in the transaction, list the information required in item 5 of Part IV on a separate sheet of paper. Enter the total (U.S. dollars) in the appropriate box in item 5, and the word "various" in other appropriate boxes.

Multiple-Transaction Instructions

If a financial institution is aware that an individual or organization has conducted a series of currency transactions in one day at the financial institution, or at different branch offices of the financial institution, totalling more than $10,000, a report should be filed for all such transactions. If a series of deposits, withdrawals, check transactions, or currency exchanges are made, enter the total of such transactions in item 2 of Part IV. Also check the "Other" box in Part IV, item 1, specifying "multiple transactions" in addition to checking the appropriate box in item 1 that describes the nature of the transactions. If more than one individual conducts multiple transactions for another person, or if an individual conducting multiple transactions for another person cannot be identified, enter "multiple transactions" on the name line of Part 1.

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Form 4789
(Rev. December 1982)
Department of the Treasury
Internal Revenue Service

Currency Transaction Report

File a separate report for each transaction
(Complete all applicable parts—see instructions)

OMB No. 1545-0183
Expires 12-31-85

Part I **Identity of individual who conducted this transaction with the financial institution**

Name (Last) ①	First	Middle Initial	Social Security Number
Number and Street			Business, occupation, or profession (1a)
City	State	ZIP code	Country (if not U.S.) ②

Method of verifying identification:

☐ Driver's permit .... (State) ③ .... (Number)   ☐ Alien ID card .... (Country) .... (Number)

☐ Passport .... (Country) .... (Number)   ☐ Other (specify) ....

Part II **Individual or organization for whom this transaction was completed (Complete only if different from Part I)**

Name ④			Identifying number
Number and Street			Business, occupation, or profession (4a)
City	State	ZIP code	Country (if not U.S.)

Part III **Customer's account number**

☐ Savings account ⑤ .... (Number)   ☐ Share account .... (Number)   ☐ Safety deposit box .... (Number)

☐ Checking account .... (Number)   ☐ Loan account .... (Number)   ☐ Other (specify) ....

Part IV **Description of transaction. If more space is needed, attach a separate schedule and check this box** ☐

1. Nature of transaction (check the applicable boxes)
   - ☐ Deposit
   - ☐ Withdrawal ⑥ (6a)
   - ☐ Check Cashed
   - ☐ Check Purchased
   - See item 6 below
   - ☐ Currency Exchange
   - ☐ Mail/Night Deposit
   - ☐ Other (specify)

2. Total amount of currency transaction (in U.S. dollars) ⑦	3. Amount in denominations of $100 or higher ⑧	4. Date of transaction (Month, day, and year) ⑨

5. If other than U.S. currency is involved, please furnish the following information:

Currency name ⑩	Country	Total amount of each foreign currency (in U.S. dollars)

6. If a check was involved in this transaction, please furnish the following information (See instructions):

Date of check ⑪	Amount of check (in U.S. dollars)	Payee
Drawer of check		Drawee bank and City

Part V **Financial institution reporting the financial transaction**

Name and Address ⑫	Identifying number (EIN or SSN)
	Business activity

Sign here ▶ ⑬ .... (Authorized Signature) .... (Title) .... (Date)

Type or print name of authorized signer ▶

For Paperwork Reduction Act Notice, see the back of this page.

General Instructions

Paperwork Reduction Act Notice.—The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us.

The requested information is useful in criminal, tax, and regulatory investigations. In addition to directing the Federal Government's attention to unusual or questionable transactions, the reporting requirement discourages the use of currency in illegal transactions. Financial institutions are required to provide the information under 31 CFR 103.22, 103.25, and 103.26.

Who Must File.—Each financial institution must file a Form 4789 for each deposit, withdrawal, exchange of currency, or other payment or transfer, by, through, or to that financial institution, which involves a transaction in currency of more than $10,000. Multiple transactions by or for any person which in any one day total more than $10,000 should be treated as a single transaction, if the financial institution is aware of them.

Exceptions.—Banks do not have to file Form 4789 for transactions with Federal Reserve Banks, Federal Home Loan Banks, or other domestic banks.

Banks do not have to file Form 4789 for the following transactions if the amounts involved are reasonable and customary in the course of the customer's business or activities:

(1) deposits or withdrawals of currency from an existing account by an established depositor who is a U.S. resident and who—
   (a) operates a retail business in the United States (except automobile, boat, or airplane dealerships), or
   (b) operates a sports arena, race track, amusement park, bar, restaurant, hotel, licensed check cashing service, vending machine company, or theater;
(2) deposits or withdrawals, exchanges of currency, or other payments and transfers by local, state, or Federal government agencies;
(3) withdrawals for payroll purposes from an existing account by an established depositor who is a U.S. resident and who operates a firm that regularly withdraws more than $10,000 to pay employees in currency.

Banks must keep a record of customers whose transactions are not reported because of exceptions (1) through (3) above. (See 31 CFR, section 103.22 for details about what to include in this record.)

Nonbank financial institutions do not have to report transactions with commercial banks.

When and Where to File.—File this form by the 15th day after the date of the transaction with the Internal Revenue Service, Odgen, UT 84201, or hand carry it to your local IRS office. Keep a copy of each Form 4789 for 5 years from the date you file it.

Identifying Number.—For individuals this is the social security number. For others it is the Federal employer identification number (9 digits).

Identification Required.—Before completing a transaction, a financial institution must verify and record (1) the name and address of the individual making the transaction and (2) the identity, account number, and taxpayer identifying number (if any) of the individual or organization for whose account the transaction is being made. Use a passport or other official document showing nationality to verify the identity of an alien or nonresident of the United States. Use a document like a driver's license, etc., normally accepted as a means of identification when cashing checks, to verify the identity of anyone else. In each case, record on this form the method of identification used.

Penalties.—Civil and criminal penalties (up to $500,000) are provided for failure to file a report or to supply information, and for filing a false or fraudulent report. See 31 CFR, sections 103.47 and 103.49.

Specific Instructions

Part I.—

(1) In the address section, enter the permanent street address of the individual conducting the transaction. If the currency was received or shipped through the U.S. Postal Service, write in "U.S. Mail." If the currency was received in a night deposit box, write in "Night Deposit." If the currency was received or shipped through an armored car service, licensed by a state or local government, provide only the service's name and address.
(2) In the social security block, enter the social security number of the individual conducting the transaction. If the individual has no number, write "None" in this block.
(3) Check the appropriate box and enter the number of the document used to verify the identity of the individual making the transaction. When the name of an individual is not required to be given, it is not necessary to describe the method of verifying identification.

Part II.—

(1) For individuals, enter last name, first name, and middle initial, if any, in the name block in that order. For all others, enter the complete organization name.
(2) In the identifying number block, enter the social security number or employer identification number.

Part III.—

Check the appropriate box and enter the appropriate customer's account number. If there is no account relationship, check Other and write in "None."

Part IV, line 1.—

If the transaction being reported was the sale or purchase of foreign currency, check Other and write in "sale of foreign currency" or "purchase of foreign currency," whichever applies.

Part IV, line 6.—

Complete this line if a check is cashed or a bank check is purchased with currency.

Part V.—

Institutions may also enter in the name and address block other identifying information.

Signature.—This report must be signed by an authorized individual. Also type or print the name of the authorized signer.

Definitions

Bank.—Each agent, agency, branch, or office in the United States of a foreign bank and each agency, branch, or office in the United States of any person doing business in one or more of the capacities listed below:

(1) a commercial bank or trust company organized under the laws of any state or of the United States,
(2) a private bank,
(3) a savings and loan association or a building and loan association organized under the laws of any state or of the United States,
(4) an insured institution as defined in section 401 of the National Housing Act,
(5) a savings bank, industrial bank, or other thrift institution,
(6) a credit union organized under the laws of any state or of the United States, and
(7) any other organization chartered under the banking laws of any state and subject to the supervision of the bank supervisory authorities of a state.

Currency.—The coin and currency of the United States or of any other country, which circulate in and are customarily used and accepted as money in the country in which issued. It includes United States silver certificates, United States notes, and Federal Reserve notes, but does not include bank checks or other negotiable instruments not customarily accepted as money.

Financial Institution.—Each agency, branch, or office in the United States of any person doing business in one or more of the capacities listed below:

(1) a bank;
(2) a broker or dealer in securities, registered or required to be registered with SEC under the Securities Exchange Act of 1934;
(3) a person who engages as a business in dealing in or exchanging currency (for example, a dealer in foreign exchange or a person engaged primarily in the cashing of checks);
(4) a person who engages as a business in issuing, selling, or redeeming traveler's checks, money orders, or similar instruments, except one who does so as a selling agent exclusively, or as an incidental part of another business;
(5) a licensed transmitter of funds, or other person engaged in the business of transmitting funds abroad for others.

Person.—An individual, corporation, partnership, trust or estate, joint stock company, association, syndicate, joint venture, or other unincorporated organization or group, and all entities treated as legal personalities.

Transaction in Currency.—A transaction involving the physical transfer of currency from one person to another. A transaction in currency does not include a transfer of funds by means of bank check, bank draft, wire transfer, or other written order that does not include the physical transfer of currency.

How to order Form 4789:

If you need to order Form 4789, please use the order blank provided below. Send your order to the IRS Forms Distribution Center list for your state.

Alabama—Caller No. 848, Atlanta, GA 30370
Alaska—P.O. Box 126, Fresno, CA 93778
Arizona—P.O. box 12626, Fresno, CA 93778
Arkansas—P.O. Box 2924, Austin, TX 78769
California—P.O. Box 12626, Fresno, CA 93778
Colorado—P.O. Box 2924, Austin, TX 78759
Connecticut—P.O. Box 1040, Methuen, MA 01844
Delaware—P.O. Box 25866, Richmond, VA 23260
District of Columbia—P.O. Box 25866, Richmond, VA 23260
Florida—Caller No. 848, Atlanta, GA 30370
Georgia—Caller No. 848, Atlanta, GA 30370
Hawaii—P.O. Box 12626, Fresno, CA 93778
Idaho—P.O. Box 12626, Fresno, CA 93778
Illinois—6000 Manchester Trafficway Terrace, Kansas City, MO 64130
Indiana—P.O. Box 636, Florence, KY 41042
Iowa—6000 Manchester Traffic Terrace, Kansas City, MO 64130
Kansas—P.O. Box 2924, Austin, TX 78759
Kentucky—P.O. Box 636, Florence, KY 41042
Louisiana—P.O. Box 2924, Austin, TX 78769
Main—P.O. Box 1040, Methuen, MA 01844
Maryland—P.O. Box 25866, Richmond, VA 23260
Massachusetts—P.O. Box 1040, Methuen, MA 01844
Michigan—P.O. Box 636, Florence, KY 41042
Minnesota—6000 Manchester Trafficway Terrace, Kansas City, MO 64130
Mississippi—Caller No. 848, Atlanta, GA 30370
Missouri—6000 Manchester Trafficway Terrace, Kansas City, MO 64130
Montana—P.O. Box 12626, Fresno, CA 93778
Nebraska—6000 Manchester Trafficway Terrace, Kansas City, MO 64130
Nevada—P.O. Box 12626, Fresno, CA 93778
New Hampshire—P.O. Box 1040, Methuen, MA 01844
New Jersey—P.O. Box 25866, Richmond, VA 23260
New Mexico—P.O. Box 2924, Austin, TX 78769
New York—
Western New York—P.O. Box 240, Buffalo, NY 14201
Eastern New York (including NY City)—P.O. Box 1040, Methuen, MA 01844
North Carolina—Caller No. 848, Atlanta, GA 30370
North Dakota—6000 Manchester Trafficway Terrace, Kansas City, MO 64130
Ohio—P.O. Box 636, Florence, KY 41042
Oklahoma—P.O. Box 2924, Austin, TX 78769
Oregon—P.O. Box 12626, Fresno, CA 93778
Pennsylvania—P.O. Box 25866, Richmond, VA 23260
Rhode Island—P.O. Box 1040, Methuen, MA 01844
South Carolina—Caller No. 848, Atlanta, GA 30370
South Dakota—6000 Manchester Trafficway Terrace, Kansas City, MO 64130
Tennessee—Caller No. 848, Atlanta, GA 30370
Texas—P.O. Box 2924, Austin, TX 78769
Utah—P.O. Box 12626, Fresno, CA 93778
Vermont—P.O. Box 1040, Methuen, MA 01844
Virginia—P.O. Box 25866, Richmond, VA 23260
Washington—P.O. Box 12626, Fresno, CA 93778
West Virginia—P.O. Box 636, Florence, KY 41042
Wisconsin—6000 Manchester Trafficway Terrace, Kansas City, MO 64130
Wyoming—P.O. Box 2924, Austin, TX 78769

Foreign Addresses—Taxpayers with mailing addresses in foreign countries should send their requests for forms and publications to
Internal Revenue Service
P.O. Box 25866
Richmond, VA 23260

Puerto Rico—Director's Representative, U.S. Internal Revenue Service, Federal Office Building, Chardon Street, Hato Rey, PR 00918.

Virgin Islands—Department of Finance, Tax Division, Charlotte Amalie, St. Thomas, VI 00801.

☆U.S. GOVERNMENT PRINTING OFFICE 1993 361-117/4466

Detach At This Line

Internal Revenue Service

Form Number	Quantity
4789	

Name
Number and street
City or town, State and Zip code

Customs Use Only

Control No

31 USC 5316; 31 CFR 103.23 and 103.25

Please Type or Print

DEPARTMENT OF THE TREASURY
UNITED STATES CUSTOMS SERVICE

REPORT OF INTERNATIONAL TRANSPORTATION OF CURRENCY OR MONETARY INSTRUMENTS

Form Approved
OMB No. 1515-0079

This form is to be filed with the United States Customs Service

Privacy Act Notification on reverse

PART I - FOR INDIVIDUAL DEPARTING FROM OR ENTERING THE UNITED STATES

1. NAME *(Last or family, first and middle)*
2. IDENTIFYING NO. *(See instructions)*
3. DATE OF BIRTH *(Mo/Day/Yr)*
4. PERMANENT ADDRESS IN UNITED STATES OR ABROAD
5. OF WHAT COUNTRY ARE YOU A CITIZEN/SUBJECT?
6. ADDRESS WHILE IN THE UNITED STATES
7. PASSPORT NO. & COUNTRY
8. U.S. VISA DATE
9. PLACE UNITED STATES VISA WAS ISSUED
10. IMMIGRATION ALIEN NO. *(If any)*
11. CURRENCY OR MONETARY INSTRUMENT WAS: *(Complete 11A or 11B)*

A. EXPORTED		B. IMPORTED	
Departed From: *(City in U.S.)*	Arrived At: *(Foreign City/Country)*	From: *(Foreign City/Country)*	At: *(City in U.S.)*

PART II - FOR PERSON SHIPPING, MAILING OR RECEIVING CURRENCY OR MONETARY INSTRUMENTS

12. NAME *(Last or family, first and middle)*
13. IDENTIFYING NO. *(See instructions)*
14. DATE OF BIRTH *(Mo/Da/Yr)*
15. PERMANENT ADDRESS IN UNITED STATES OR ABROAD
16. OF WHAT COUNTRY ARE YOU A CITIZEN/SUBJECT?
17. ADDRESS WHILE IN THE UNITED STATES
18. PASSPORT NO. & COUNTRY
19. U.S. VISA DATE
20. PLACE UNITED STATES VISA WAS ISSUED
21. IMMIGRATION ALIEN NO. *(If any)*

22. CURRENCY OR MONETARY INSTRUMENTS	23. CURRENCY OR MONETARY INSTRUMENTS	NAME AND ADDRESS	24. IF THE CURRENCY OR MONETARY INSTRUMENT WAS MAILED, SHIPPED, OR TRANSPORTED COMPLETE BLOCKS A AND B.
DATE SHIPPED	☐ Shipped To		A. Method of Shipment *(Auto, U.S. Mail, Public Carrier, etc.)*
DATE RECEIVED	☐ Received From		B. Name of Transporter/Carrier

PART III - CURRENCY AND MONETARY INSTRUMENT INFORMATION (SEE INSTRUCTIONS ON REVERSE) (To be completed by everyone)

25. TYPE AND AMOUNT OF CURRENCY/MONETARY INSTRUMENTS		Value in U.S. Dollars	26. IF OTHER THAN U.S. CURRENCY IS INVOLVED, PLEASE COMPLETE BLOCKS A AND B *(SEE SPECIAL INSTRUCTIONS)*
Coins	☐ A. ▶	$	
Currency	☐ B. ▶		A. Currency Name
Other Instruments *(Specify Type)*	☐ C. ▶		
(Add lines A, B and C)	TOTAL AMOUNT ▶	$	B. Country

[illegible] - GENERAL - TO BE COMPLETED BY ALL TRAVELERS, SHIPPERS AND RECIPIENTS

27. WERE YOU ACTING AS AN AGENT, ATTORNEY OR IN CAPACITY FOR ANYONE IN THIS CURRENCY OR MONETARY INSTRUMENT ACTIVITY? *(If "Yes" complete A, B and C)* ☐ Yes ☐ No

PERSON IN WHOSE BEHALF YOU ARE ACTING ▶	A. Name	B. Address	C. Business activity occupation or profession

Under penalties of perjury, I declare that I have examined this report, and to the best of my knowledge and belief it is true, correct and complete.

28. NAME AND TITLE	29. SIGNATURE	30. DATE

(Replaces IRS Form 4790 which is obsolete)

Customs Form 4790 (120384)

BEST COPY AVAILABLE

GENERAL INSTRUCTIONS

This report is required by Treasury Department regulations (31 Code of Federal Regulations 103).

Who Must File. — Each person who physically transports, mails, or ships, or causes to be physically transported, mailed, shipped or received currency or other monetary instruments in an aggregate amount exceeding $10,000 on any one occasion from the United States to any place outside the United States, or into the United States from any place outside the United States.

A TRANSFER OF FUNDS THROUGH NORMAL BANKING PROCEDURES WHICH DOES NOT INVOLVE THE PHYSICAL TRANSPORTATION OF CURRENCY OR MONETARY INSTRUMENTS IS NOT REQUIRED TO BE REPORTED.

Exceptions. — The following persons are not required to file reports: (1) a Federal reserve bank, (2) a bank, a foreign bank, or a broker or dealer in securities in respect to currency or other monetary instruments mailed or shipped through the postal service or by common carrier, (3) a commercial bank or trust company organized under the laws of any State or of the United States with respect to overland shipments of currency or monetary instruments shipped to or received from an established customer maintaining a deposit relationship with the bank, in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the business, industry or profession of the customer concerned, (4) a person who is not a citizen or resident of the United States in respect to currency or other monetary instruments mailed or shipped from abroad to a bank or broker or dealer in securities through the postal service or by common carrier, (5) a common carrier of passengers in respect to currency or other monetary instruments in the possession of its passengers, (6) a common carrier of goods in respect to shipments of currency or monetary instruments not declared to be such by the shipper, (7) a travelers' check issuer or its agent in respect to the transportation of travelers' checks prior to their delivery to selling agents for eventual sale to the public, nor by (8) a person engaged as a business in the transportation of currency, monetary instruments and other commercial papers with respect to the transportation of currency or other monetary instruments overland between established offices of banks or brokers or dealers in securities and foreign persons.

WHEN AND WHERE TO FILE:

A. Recipients. — Each person who receives currency or other monetary instruments shall file Form 4790, within 30 days after receipt, with the Customs officer in charge at any port of entry or departure or by mail with the Commissioner of Customs, Attention: Currency Transportation Reports, Washington, D.C. 20229.

B. Shippers or Mailers. — If the currency or other monetary instrument does not accompany the person entering or departing the United States, Form 4790 may be filed by mail on or before the date of entry, departure, mailing, or shipping with the Commissioner of Customs, Attention: Currency Transportation Reports, Washington, D.C. 20229.

C. Travelers. — Travelers carrying currency or other monetary instruments with them shall file Form 4790 at the time of entry into the United States or the time of departure from the United States with the Customs officer in charge at any Customs port of entry or departure.

An additional report of a particular transportation, mailing, or shipping of currency or the monetary instruments, is not required if a complete and truthful report has already been filed. However, no person otherwise required to file a report shall be excused from liability for failure to do so if, in fact, a complete and truthful report has not been filed. Forms may be obtained from any United States Customs Service office.

PENALTIES. — Civil and criminal penalties, including under certain circumstances a fine of not more than $500,000 and imprisonment of not more than five years, are provided for failure to file a report, supply information, and for filing a false or fraudulent report. In addition, the currency or monetary instrument may be subject to seizure and forfeiture. See sections 103.47, 103.48 and 103.49 of the regulations.

DEFINITIONS:

Bank. — Each agent, agency, branch or office within the United States of a foreign bank and each agency, branch or office within the United States of any person doing business in one or more of the capacities listed: (1) a commercial bank or trust company organized under the laws of any state or of the United States, (2) a private bank, (3) a savings and loan association or a building and loan association organized under the laws of any state or of the United States, (4) an insured institution as defined in section 401 of the National Housing Act, (5) a savings bank, industrial bank or other thrift institution, (6) a credit union organized under the laws of any state or of the United States, and (7) any other organization chartered under the banking laws of any state and subject to the supervision of the bank supervisory authorities of a state.

Foreign Bank. — A bank organized under foreign law, or an agency, branch or office located outside the United States of a bank. The term does not include an agent, agency, branch or office within the United States of a bank organized under foreign law.

Broker or Dealer in Securities. — A broker or dealer in securities, registered or required to be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

INDENTIFYING NUMBER. — Individuals must enter their social security number, if any. However, aliens who do not have a social security number should enter passport or alien registration number. All others should enter their employer identification number.

Investment Security. — An instrument which: (1) is issued in bearer or registered form, (2) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment, (3) is either one of a class or series or by its terms is divisible into a class or series of instruments; and (4) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

Monetary Instruments. — Coin or currency of the United States or of any other country, travelers' checks, money orders, investment securities in bearer form or otherwise in such form that title thereto passes upon delivery, and negotiable instruments (except warehouse receipts or bills of lading) in bearer form or other in such form that title thereto passes upon delivery. The term includes bank checks, travelers' checks and money orders which are signed but on which the name of the payee has been omitted, but does not include bank checks, travelers' checks or money orders made payable to the order of a named person which have not been endorsed or which bear restrictive endorsements.

Person. — An individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, and all entities cognizable as legal personalities.

SPECIAL INSTRUCTIONS:

You should complete each line which applies to you. Part II. — Line 22. Enter the exact date you shipped or received currency or the monetary instrument(s). Line 23. Check the applicable box and give the complete name and address of the shipper or recipient. Part III. — Line 26. If currency or monetary instruments of more than one country is involved attach a schedule showing each kind, country, and amount.

PRIVACY ACT AND PAPERWORK REDUCTION ACT NOTICE

Pursuant to the requirements of Public Law 93-579, (Privacy Act of 1974), notice is hereby given that the authority to collect information on Form 4790 in accordance with 5 U.S.C. 552a(e)(3) is Public Law 91-508; 31 U.S.C. 5316; 5 U.S.C. 301; Reorganization Plan No. 1 of 1950; Treasury Department No. 165, revised, as amended; 31 CFR 103, and 44 U.S.C. 3501.

The principal purpose for collecting the information is to assure maintenance of reports or records where such reports or records have a high degree of usefulness in criminal, tax or regulatory investigations or proceedings. The information collected may be provided to those officers and employees of the Customs Service and any other constituent unit of the Department of the Treasury who have a need for the records in the performance of their duties. The records may be referred to any other department or agency of the Federal Government upon the request of the head of such department or agency.

Disclosure of this information is mandatory. Failure to provide all or any part of the requested information may subject the currency or monetary instruments to seizure and forfeiture, as well as subject the individual to civil and criminal liabilities.

Disclosure of the social security number is mandatory. The authority to collect this number is 31 CFR 103.25. The social security number will be used as a means to identify the individual who files the report.

The collection of this information is mandatory pursuant to 31 U.S.C. 5316.

Exhibit 11

129

EOP

SECTION: CURRENCY AND FOREIGN TRANSACTIONS REPORTING ACT

SUBJECT: SAME

I. INTRODUCTION

The Currency and Foreign Transactions Reporting Act which was passed by Congress in 1970 was intended to minimize tax evasion, "laundering" of illicit funds and to forestall other white collar crime. As a result of this legislation, the Financial Recordkeeping and Reporting Regulations (31 CFR Part 103) were issued on March 31, 1972.

The following procedures for testing compliance with the Financial Recordkeeping and Reporting Regulations are divided into minimum scope procedures and an expanded scope procedure.

The minimum scope procedures require the examiner to determine whether the institution has appropriate operating and auditing standards. In addition they require the examiner to conduct a detailed review of the institution's internal audit function and entail the examination of procedures and selected work papers, reports and responses. This review should enable the examiner to decide whether to conclude the review or examine further, based upon specified criteria.

The expanded procedure involves conducting a review of a sample of actual transactions and related documentation.

II. EXAMINATION OBJECTIVE

To determine if the association is in compliance with the Currency and Foreign Transactions Reporting Act and its implementing regulations.

III. EXAMINATION PROCEDURES

A. Minimum Scope Procedures

1. Ascertain whether the institution has established, in writing, formal operating procedures to ensure compliance with the regulations. It may be acceptable for small institutions to operate under standard procedures not reduced to writing.

    a. Reporting - Operating procedures should set forth the requirements of the regulations and establish compliance guidelines with respect to large cash transactions and exemptions granted to customers.

SECTION: CURRENCY AND FOREIGN TRANSACTIONS REPORTING ACT

SUBJECT: SAME

b. Recordkeeping - The institution's record retention schedule should, at a minimum, include the record retention requirements of the regulations. Furthermore, requirements for the maintenance of lists of exempt customers with retail affiliations and customers from whom taxpayer identification numbers have not been obtained should be included.

2. Obtain a copy of the institution's list of exempt customers. Through a review of this document, determine:

   a. whether its contents conform to the requirements of the regulations (name, address, business, nine-digit Federal taxpayer identification number, reason for exemption, etc.), and that the exemptions appear reasonable.

   b. whether the institution has, in granting exemptions, adhered to its established policy.

3. Review the file of reports submitted (4789 and 4790) and ascertain whether they were properly completed and filed as required.

4. The examiner should ascertain whether the institution has established a program of employee education with regard to the requirements of the regulations.

   a. Tellers, through an ongoing training program, should be apprised of the reporting requirements for large cash transactions.

   b. Operations personnel should be made aware of the current requirements of the regulations and management should periodically reinforce the importance of compliance.

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c. Operations personnel (i.e., tellers, branch managers) should be interviewed to ascertain whether they are sufficiently knowledgeable concerning the regulations and operating procedures to assure compliance. This phase of the examination should be conducted at those branches which conduct relatively large volumes of cash business.

PROCEDURE 5 IS TO BE OMITTED IF THE INSTITUTION DOES NOT HAVE AN INTERNAL AUDIT FUNCTION. IN SUCH CASES, THE EXAMINER SHOULD ASCERTAIN WHETHER A PROGRAM OF MANAGEMENT REVIEWS OR SELF AUDITS HAS BEEN ESTABLISHED WHICH ENCOMPASSES THE REQUIREMENTS OF THE REGULATIONS.

5. The examiner should test the institution's internal audit procedures and determine whether the internal audit function provides coverage of the following sections of the regulations.

   a. Reporting - Coverage of the reporting requirements should be found in the procedures and should include a review of actual tellers' work and Forms 4789 and 4790.

   b. Recordkeeping - Coverage of the institutions' recordkeeping activities should encompass a test of adherence to the in-house record retention schedule. This schedule should meet the requirements of the regulations.

   c. Exemptions - Coverage should include audit steps necessary to ascertain whether the institution is maintaining a list of exempt customers which includes their retail affiliation as required by the regulations. The audit procedure should provide a test of the reasonableness of the exemptions granted.

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d. Foreign Accounts - Coverage in this area should require the auditor to ascertain whether the institution has filed Form 90-22.1 declaring interest in a foreign financial account.

6. Review the results of the prior examination report and follow-up on any deficiencies.

7. Complete FHLBB Form 919 "Financial Recordkeeping and Reporting Regulations."

The expanded scope procedure should be employed when the above procedures disclose any of the following:

1. The association does not maintain adequate records; or

2. The association consistently does not file the required reports; or

3. Answers to the checklist indicate that there have not been any transactions subject to the Bank Secrecy Act; or

4. There is evidence that there is no training of personnel and/or tellers and others who would otherwise handle cash; or

5. Violations of the Bank Secrecy Act are not isolated and/or violations are willful or repetitive.

B. Expanded Procedure

Test daily transactions to determine whether there is evidence of association failure to adhere to the requirements of the regulations. This may be accomplished by reviewing the records of a group of tellers, a branch or the entire association for a selected period of five to ten days. Note and report on transactions which were covered by the regulation but which were not handled in compliance with the regulations.

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Exhibit 14

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

M E M O R A N D U M AB 59

TO: Principal Supervisory Agents

June 12, 1985

FROM: William J. Schilling

Money Laundering
in Financial
Institutions

Attached for your information is a letter from John M. Walker, Jr., Assistant Secretary, Department of the Treasury, on the subject of money laundering. It is our understanding that the letter was sent to the CEOs of all insured banks and savings and loans.

William Schilling
Director

Attachment

cc: District Directors-Examinations
Assistant Directors for Regional Operations

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

May 1, 1985

Dear Chief Executive Officer:

I am writing to bring an urgent matter to your attention: the need to guard against money laundering that has taken place in major U.S. financial institutions and that could easily occur in a financial institution such as yours. You are no doubt aware that drug traffickers and other criminal operatives are going to great lengths to conceal the sources of their illegal proceeds and to keep law enforcement from obtaining information concerning their financial activities. To accomplish this, they are resorting to every conceivable method of keeping their large transactions from being reported to the government as required under the Bank Secrecy Act and Treasury's implementing regulations. Money laundering through legitimate institutions directly supports drug trafficking and organized crime and is today a multibillion dollar problem for our society.

When organized crime can subvert our legitimate financial institutions for its own ends, our society pays a heavy price. The laundered proceeds are used to finance drug deals, racketeering, loansharking, official bribery, and other serious offenses. Money laundering erodes the public's confidence in our financial system. Furthermore, the consequences for the financial institution that fails to be vigilant to guard against money laundering are severe. In addition to facing substantial civil and criminal penalties, it can lose its most valuable asset: the trust of the community its serves.

For all of these reasons, every bank and savings and loan institution has a major stake in ensuring that it does not become the agent for laundering criminal proceeds. Because full compliance with the reporting and recordkeeping requirements of the Bank Secrecy Act is an essential safeguard, every institution must have an effective system for monitoring compliance and for training its employees. It is also critical that suspicious transactions be reported to the Criminal Investigation Division at your local office of the Internal Revenue Service. Programs to assist your institution in accomplishing these goals are now available, including some being sponsored by the American Bankers Association and various state banking associations. I urge you to give them serious consideration. These programs teach procedures to ensure proper filing of currency transaction reports and instruct employees on ways to recognize suspicious transactions.

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There has never been a more important time for a bank or savings and loan institution to know its customers. In particular, every institution must scrutinize closely any customer desiring to be exempt from the reporting requirements, to ensure that all regulatory requirements for exemption are met and to verify that the information received from the customer is current and reliable. To fail to know a customer is to risk liability by contributing to the success of a criminal enterprise.

Finally, let me emphasize that Bank Secrecy Act compliance should not be regarded solely as the responsibility of tellers, supervisors and branch managers. It is critical that the entire organization, particularly top management, be firmly committed to the goals of maintaining full compliance and preventing access by organized crime. Your Federal government is waging an all-out attack on money laundering, but we cannot succeed without the full cooperation and assistance of the financial community. I hope and trust that you will give this problem your personal attention and take the steps necessary to ensure that your institution is doing everything in its power to prevent money laundering.

Sincerely,

John M. Walker, Jr.
Assistant Secretary
(Enforcement and Operations)

Exhibit 15

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

MEMORANDUM AB 62

TO: Principal Supervisory Agents August 5, 1985

FROM: William J. Schilling

Currency and
Foreign
Transactions
Reporting Act
(a.k.a. the Bank
Secrecy Act)

Your attention is directed to Memorandum T 53-7, dated May 23, 1985, and to Memorandum AB 39, dated June 12, 1985. In order to better determine the existence of possible money laundering activities, as well as the existence of regulatory violations, Directors of Examinations within your banks should adopt the following procedures with regard to examinations made for institutions' compliance with the Bank Secrecy Act ("BSA"). The procedures apply to every regularly-scheduled examination.

FHLBB Form 919 (Examiner's Checklist)

Examiners should be reminded that in determining institution compliance with the BSA it is their responsibility to (1) personally complete FHLBB Form 919 and to (2) personally verify the representations made by management used in completing the form.

Other Procedures

1. Until the new Examination Objectives and Procedures manual is completed, examiners should use the BSA examination program issued in June 1981 (no. 377, copy attached). A supply of the program workpapers may be obtained from OES Administrative Officer Mary F. Ramsey (202/377-6640).

2. Examiners should also be reminded of their responsibility to employ the expanded scope procedures in the circumstances listed on the second page of the BSA examination program. In addition, expanded scope procedures should be employed as a means to insure that an institution has taken steps necessary to preclude the continuation of violations that had been reported in a preceding examination, and may also be employed whenever deemed appropriate by an examiner.

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AB 62
Page 2

3. Violations of a material or suspicious nature, or of a significant number, are to be the subject of an immediate interim report by examination to supervision. Procedures for recommending civil and criminal penalties, presented in Memorandum T 53-6, dated December 11, 1980, and the guidelines for recommendations concerning the assessment of civil penalties and for referrals of criminal investigations, attached to Memorandum SP 31, dated July 22, 1983, remain in effect.

4. Supervision will process the interim report to the Assistant Director for Regional Operations who, when deemed necessary, will notify the Treasury Department of the facts presented in the report and will consult with it as to how to further proceed.

For additional information you may contact your Assistant Director for Regional Operations.

William Schilling
William J. Schilling
Director

Attachment

cc: Professional Staff - Examinations and Supervision

Distribution to State supervisory authorities to be made by Directors of Examinations.

FEDERAL HOME LOAN BANK BOARD
OFFICE OF EXAMINATIONS AND SUPERVISION

EXAMINATION PROGRAM

CURRENCY AND FOREIGN TRANSACTIONS REPORTING ACT

EXAMINATION OBJECTIVE

- To determine whether the association is in compliance with the Currency and Foreign Transactions Reporting Act and its implementing regulations.

EXAMINATION PROCEDURES

Minimum Procedures:

The following procedures must be completed on each examination.

Wkp. Ref.		Work Done By	Date
____	1. Ascertain whether the institution has established, in writing, formal operating procedures to ensure compliance with the regulations. It may be acceptable for small institutions to operate under standard procedures not reduced to writing.	____	____
	2. Obtain a copy of the institution's list of exempt customers. Through a review of this document, determine:		
____	a. whether its contents conform to the requirements of the regulations (name, address, business, nine-digit Federal taxpayer identification number, reason for exemption, etc.), and that the exemptions appear reasonable.	____	____
____	b. whether the institution has, in granting exemptions, adhered to its established policy.	____	____
____	3. Review the file of reports submitted (4789 and 4790) and ascertain whether they were properly completed and filed as required.	____	____
	4. The examiner should ascertain whether the institution has established a program of employee education with regard to the requirements of the regulations.		
____	a. Tellers, through an ongoing training program, should be apprised of the reporting requirements for large cash transactions.	____	____
____	b. Operations personnel should be made aware of the current requirements of the regulations and management should periodically reinforce the importance of compliance.	____	____
____	c. Operations personnel (i.e., tellers, branch managers) should be interviewed to ascertain whether they are sufficiently knowledgeable concerning the regulations and operating procedures to assure compliance. This phase of the examination should be conducted at those branches which conduct relatively large volumes of cash business.	____	____

PROCEDURE 5 IS TO BE OMITTED IF THE INSTITUTION DOES NOT HAVE AN INTERNAL AUDIT FUNCTION. IN SUCH CASES, THE EXAMINER SHOULD ASCERTAIN WHETHER A PROGRAM OF MANAGEMENT REVIEWS OR SELF AUDITS HAS BEEN ESTABLISHED WHICH ENCOMPASSES THE REQUIREMENTS OF THE REGULATIONS.

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FEDERAL HOME LOAN BANK BOARD
OFFICE OF EXAMINATIONS AND SUPERVISION

Wkp. Ref. | Work Done By Date

5. The examiner should test the institution's internal audit procedures and determine whether the internal audit function provides coverage of the following sections of the regulations.

   a. Reporting - Coverage of the reporting requirements should be found in the procedures and should include a review of actual tellers' work and Forms 4789 and 4790.

   b. Recordkeeping - Coverage of the institutions' recordkeeping activities should encompass a test of adherence to the in-house record retention schedule. This schedule should meet the requirements of the regulations.

   c. Exemptions - Coverage should include audit steps necessary to ascertain whether the institution is maintaining a list of exempt customers which includes their retail affiliation as required by the regulations. The audit procedure should provide a test of the reasonableness of the exemptions granted.

   d. Foreign Accounts - Coverage in this area should require the auditor to ascertain whether the institution has filed Form 90-22.1 declaring interest in a foreign financial account.

6. Review the results of the prior examination report and follow-up on any deficiencies.

7. Complete FHLBB Form 919 "Financial Recordkeeping and Reporting Regulations."

The expanded scope procedure should be employed when the above procedures disclose any of the following:

1. The association does not maintain adequate records; or
2. The association consistently does not file the required reports; or
3. Answers to the checklist indicate that there have not been any transactions subject to the Bank Secrecy Act; or
4. There is evidence that there is no training of personnel and/or tellers and others who would otherwise handle cash; or
5. Violations of the Bank Secrecy Act are not isolated and/or violations are willful or repetitive.

Expanded Procedure:

Test daily transactions to determine whether there is evidence of association failure to adhere to the requirements of the regulations. This may be accomplished by reviewing the records of a group of tellers, a branch or the entire association for a selected period of five to ten days. Note and report on transactions which were covered by the regulation but which were not handled in compliance with the regulations.

EXAMINER'S FINDINGS

Is the association in complaince with the Currency and Foreign Transactions Reporting Act and its implementing regulations?

Yes ____ No ____ ____ Examiner See W/P ____

Exhibit 16

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

MEMORANDUM AB 63

TO: Principal Supervisory Agents October 28, 1985

FROM: Francis M. Passarelli

Currency and
Foreign
Transactions
Reporting Act
(a.k.a. the Bank
Secrecy Act)

Attached for your information is a copy of a September 16, 1985 letter to this office from the Department of the Treasury which includes a copy of a September 6, 1985 Treasury Department Order (TDO No. 105-13) delegating to the Commissioner of Internal Revenue certain authorities and a responsibility relative to the Bank Secrecy Act.

While TDO No. 105-13 is an internal policy matter within the Treasury Department, your attention is directed to the second and third paragraphs of the September 16 letter. (As you know, the meaning of the word "bank" as used in the letter and as defined by BSA regulations includes savings and loan associations.) As the second paragraph indicates, on an ongoing basis this office is receiving Treasury Department notifications to suspend BSA compliance examinations, but to date the notifications have been few in number and they have applied only to a few districts. With respect to the third paragraph, our existing guidelines for the routing of referrals of recommendations of civil and criminal penalties are attached to Memorandum SP 31.

Another point to be made is that after the IRS has completed an investigation and the Treasury Department has so notified us, our examining procedures should not in any way be reduced upon our resumption of an examination for compliance with BSA regulations. We have been informed that IRS investigations generally are done for a grand jury and in such cases the submitted evidence is not releasable until it becomes a matter of public record.

Francis Passarelli
Acting Director

Attachments.

cc: Professional Staff - Examinations and Supervision

Distribution to state supervisory authorities to be made by Directors of Examinations.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

SEP 16 1985

SEP 18 9 53 AM '85
O[illegible] EXAMS
[illegible] SUPVN.
[illegible] L.B.B.

Dear Mr. Passarelli:

Enclosed is a copy of Treasury Department Order (TDO) 105-13 dated September 6, 1985. This document delegates to the Commissioner of Internal Revenue additional authority and responsibility under 31 CFR Part 103.

This office will continue to notify appropriate bank supervisory authorities and the Securities & Exchange Commission to suspend Bank Secrecy Act compliance examinations when the IRS initiates an investigation of an apparent criminal violation of the Act. The IRS will furnish us with periodic status reports on these cases, and we will notify you when the compliance examinations may be resumed.

There should be no change in the routing of referrals of serious violations which may result in civil or criminal sanctions. Such referrals, including recommendations for civil penalties, should be directed to this office.

The IRS has not been delegated sole authority to grant, deny, and review bank exemption lists. The Assistant Secretary (Enforcement & Operations) has the same authority and will resolve any conflicts relating to exemption decisions. Interpretations of the regulations will continue to be issued by this office.

If you have any questions relating to the order, please contact Mr. Robert Stankey of my staff at 566-8022.

Sincerely,

David D. Queen

David D. Queen
Deputy Assistant Secretary
(Enforcement)

Mr. Francis M. Passarelli
Acting Director
Division of Examination & Supervision
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, D.C. 20552

DEPARTMENT OF THE TREASURY ORDER

Number: 105-13

Date: SEP 6 1985

Subject: Delegation of Authority to the Commissioner of Internal Revenue, to Perform Certain Functions Related to the Enforcement of 31 CFR 103 (Bank Secrecy Act Regulations)

By virtue of the authority vested in the Secretary of the Treasury and pursuant to the authority delegated to me as Assistant Secretary (Enforcement and Operations), including that delegated to me by Treasury Department Order No. 101-5 and 31 CFR 103.46(b), as amended, there is hereby delegated to the Commissioner of Internal Revenue the following authorities necessary to carry out the Department of the Treasury responsibilities under 31 CFP Part 103:

(1) Authority to initiate investigations of banks and brokers or dealers in securities for possible criminal violations of 31 CFR Part 103.

(2) Authority to grant exemptions from the reporting requirements contained in 31 CFR 103.22.

(3) Authority to issue requests for lists of financial institution customers whose currency transactions have been exempted from the reporting requirement in 31 CFR 103.22.

(4) Authority to direct banks to file currency transaction reports as prescribed in 31 CFR 103.22(a) with respect to customers whose transactions had been previously exempted.

(5) Responsibility to assure compliance with the requirements of 31 CFR Part 103 by all banks not currently examined by Federal bank supervisory agencies for safety and soundness.

This Order does not authorize the Commissioner to amend 31 CFR Part 103.

David D. Queen

David D. Queen
Acting Assistant Secretary
(Enforcement and Operations)

Exhibit 17

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

Federal Home Loan Bank Board

OFFICE OF EXAMINATIONS AND SUPERVISION

July 29, 1985

MEMORANDUM FOR: Principal Supervisory Agents

FROM: William J. Schilling, Director

SUBJECT: Bank Secrecy Act

I have attached a copy of my testimony before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the U. S. Senate on July 25, 1985. I would encourage you to review it, especially pages 12-17 which deal with the Board's efforts to improve our activities with regard to the Bank Secrecy Act. All of these recommendations have been reviewed and approved by Chairman Gray.

You will be receiving from Washington several additional procedural directives related to commitments made to, or requested by, the subcommittee. In addition, our examination and supervisory procedures will be reviewed by both the EOP and SOP task forces.

I recognize that our examination resources are still scarce and that our paramount concern remains that of safety and soundness. However, drug trafficking and money laundering is also of grave concern to the Congress and the Board. It is extremely important that when any evidence of such activities come to our attention that it is promptly brought to the attention of supervision and that appropriate communication and coordination is undertaken with the Treasury and Justice Departments.

Both Bob Moore and Frank Passarelli of my office are working on this matter and will be in communication with the Bank Presidents' supervision and examination subcommittee headed by Don Hoby.

Attachment

cc: Chairman Gray
Dr. Eugene Byrne

bcc w/o attachments:
Bob Moore
Frank Passarelli
RDROs
Rosemary Stewart ✓
[illegible] Withers

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Exhibit 18

Federal Home Loan Bank Board

1700 G Street, N.W.
Washington, D.C. 20552

Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

OFFICE OF EXAMINATIONS AND SUPERVISION

March 6, 1986

FROM: Francis M. Passarelli, Acting Director
Office of Examinations and Supervision

TO: Directors of Examinations

SUBJECT: Mandatory Examination Objectives

In 1982, then OES Deputy Director Dorer issued a memorandum suspending mandatory use of the procedures specified in the Manual of Examination Objectives and Procedures (MEOP). The question has arisen as to whether this instruction permits a District to cease all examinations for compliance with consumer and nondiscrimination laws in the absence of information revealing specific problems in those areas. I want to correct any misunderstanding there may be about the responsibility of examiners to examine not only for safety and soundness but also for compliance with statutes and regulations.

There is no intention on the part of OES or the Board to suspend examination for compliance with the laws and regulations the Board is charged with enforcing. All regular examinations carry a responsibility to determine whether institutions are in compliance with these laws and regulations, including laws and regulations that provide for consumer protection and nondiscrimination. It should be noted that Mr. Dorer's memorandum did not suspend the achievement of the objectives contained in the MEOP. Moreover, to the extent that there is any inconsistency between the two memoranda, this memorandum supersedes Mr. Dorer's.

Chairman Gray has issued a number of directives requiring prompt supervisory action when violations are found. The Chairman's directives encompass the full scope of laws and regulations. His directives not only set procedures for Supervision but also serve to inform all examination and supervisory staff of the importance of detecting and correcting statutory and regulatory violations.

cc: Chairman Gray
Board Member Hovde
Board Member Grigsby
Principal Supervisory Agents
Mr. Quillian
Ms. Stewart
Mr. Tucker

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Exhibit 19

Federal Home Loan Bank Board

Office of the Chairman

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

August 9, 1985

MEMORANDUM FOR: Principal Supervisory Agents

FROM: Edwin J. Gray EJG
Chairman

SUBJECT: Supervision

During a recent review of several significant supervisory cases, I have noted several deficiencies which should be corrected. While these do not occur uniformly or consistently throughout the twelve districts, I want to call their attention to all of you so that appropriate review and correction can be undertaken.

I. Annual Audits

A. Extensions: "Routine" or "repeated" extensions of time should not be allowed. Any extension should be thoroughly justified by a written request. Associations should be alerted that tardy audits and especially repeatedly tardy audits will be deemed absolutely unacceptable.

B. Change in Accountants: If there is an action terminating the services of a public accountant, voluntarily or involuntarily, the institution must notify the Director of Examinations* in writing (with a copy to the public accountant) within 10 days after the close of the month during which the termination occurs. Such notification must indicate the reason for the termination and must state whether in the past 24 months there were any unresolved issues, or alternatively, there were any disagreements with the terminated public accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing procedure, which disagreements if not resolved to the satisfaction of the terminated public accountant would have caused him to make reference, in connection with his opinion, to the subject matter of the disagreements. The institution will also request the terminated public accountant to furnish the institution with a letter (with

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*Director of Examinations is the new title of the former District Director or Chief Examiner position.

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copy to the Director of Examinations) stating whether he agrees with the statements contained in the letter of the institution and, if not, stating the respects in which he does not agree. Within 10 working days of receipt of the notification of termination, the terminated public accountant must have a meeting with the Director of Examinations, or his designee to discuss fully the reason for the termination. The institution must not appoint a replacement public accountant prior to the written notification to the institution by the Director of Examinations or his designee that this meeting has taken place. The engagement letter specified in Bulletin PA-7a, Section IV, paragraph B must be furnished to the Director of Examinations by the replacement accountant prior to the commencement of any audit work or the audit will be considered prima facie unacceptable to the Corporation.

II. Reporting Requirements

Firm supervisory action (and where needed on-site examination) should be taken where an association is repeatedly late with required reports (monthly, quarterly, brokered funds, etc.). When a significant report is substantially or repeatedly tardy, use examination personnel to obtain the information on-site at the association's expense.

III. Supervisory Directives

Many supervisory letters or directives are "open ended" and impose no timelines either for response or corrective action. All supervisory letters and directives should have a deadline for response and while not all problems are amenable to strict timetables for correction, general timelines should be imposed and adhered to. Certainly clear deadlines can and should be set for plans for corrective action and reports on the status of corrective action.

IV. Supervision and Examination Redundancies

As we more adequately staff in both examination and in supervision attention must be given to cross-training personnel and in assuring backup procedures for operations.

Lapses in monitoring, action, etc. should not be occasioned because of resignation, vacation, or other absence. In the event that a staff member becomes totally absorbed in a single case or assignment, his or her remaining caseload should be covered by other personnel.

V. Enforcement Actions

There is a perception among some members of supervisory staffs that firm supervisory and enforcement actions cannot be taken in certain cases because of a lack of legal authority. The statutory authority of the Board to initiate cease-and-desist proceedings is very broad, and its authority to issue temporary cease and desist orders and to initiate removal and prohibition actions also is broad, as the following excerpts from Section 407 of the National Housing Act indicate:

Cease-and-Desist Proceedings

> If, in the opinion of the [Federal Savings and Loan Insurance] Corporation, any insured institution . . . or any director, officer, employee, agent or other person participating in the conduct of the affairs of the institution is engaging or has engaged . . . in an unsafe or unsound practice . . . or is violating or has violated . . . a law, rule or regulation or any condition . . . or any written agreement entered into with the Corporation . . ., the Corporation may issue and serve upon the institution or . . . person a notice of charges in respect thereof. 12 U.S.C. § 1730(e).

Temporary Cease-and-Desist Orders

> Whenever the Corporation shall determine that the violation or the unsafe or unsound practice . . . specified in the notice of charges . . . or the continuation thereof, is likely to cause insolvency or substantial dissipation of assets or earnings of the institution, or is likely to seriously weaken the condition of the institution . . ., the Corporation may issue a temporary order . . . . 12 U.S.C. § 1730(f).

Removal and Prohibition Actions

> Whenever, in the opinion of the Corporation, any director or officer . . . has committed any violation of law, rule, regulation . . . or has engaged . . . in any unsafe or unsound practice . . . or breach of fiduciary duty . . . and . . . the institution has suffered . . . substantial financial loss or other damage . . . or the director has received financial gain . . . and that such violation

> or practice or breach . . . is one involving personal dishonesty . . . or . . . a willful or continuing disregard for the safety or soundness of the institution, the Corporation may serve upon such officer or director a written notice of its intention to remove him . . . . 12 C.F.R. § 1730(g).

There should be no hesitation to recommend the initiation of cease-and-desist proceedings for any significant violations of laws or regulations or for practices believed by the Supervisory Agent to be unsafe or unsound: (1) where Supervision has been unable to resolve the violations or unsound practices through informal supervisory efforts, including the use of supervisory agreements, or (2) where the violations or unsound practices are deemed by the Supervisory Agent to be so serious that cease-and-desist action, rather than informal efforts, is required in the first instance. Similarly, there should be no hesitancy to recommend temporary cease-and-desist orders or removal actions if the Supervisory Agent feels they are necessary to achieve regulatory compliance or the safe and sound operation of an institution. Even if OGC determines that the facts in a case are insufficient to pursue one remedy (such as issuance of a temporary order to cease and desist), it is almost always possible to pursue other alternatives (such as issuing a Notice of Charges and Hearing), that effectively bring the deficiencies to the attention of a troubled institution.

Last year, in a memorandum dated April 12, 1984, the Board Members and I stressed to all Supervisory Agents the need to obtain supervisory agreements to achieve corrective action for substantial problems revealed by final or interim reports of examination. We continue to believe that the expeditious execution of supervisory agreements should be sought to address significant problems at institutions, and we are pleased that a number of Districts have greatly expanded their use of such agreements in the last year. Because, as noted above, one clear ground for the institution of cease-and-desist proceedings is the violation of any written agreement (such as a supervisory agreement) with the Corporation, the prompt use of supervisory agreements to halt practices that may not initially warrant a formal proceeding may well expedite the issuance of a formal cease-and-desist order if the practice continues. Moreover, any refusal to execute an agreement by an institution and any significant violations of a supervisory agreement after it is executed should be referred to OGC Enforcement for its consideration of initiating a cease-and-desist proceeding.

With repect to removal actions, the Board notes with approval that an increased number of formal removal and prohibition orders have been negotiated by OGC Enforcement and OES in the last year. In addition, increased numbers of informal management resignations have been obtained by Supervisory Agents in cases where a formal order is not deemed necessary. All

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Supervisory Agents are encouraged to consider all of the options before them when dealing with negligent or wrongdoing management officials, and OGC Enforcement is available to discuss these options with Supervisory Agents prior to their taking any specific action. In no event should Supervisory Agents fail to take action because of any uncertainty as to the availability of formal enforcement tools.

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Exhibit 2[illegible]

Federal Home Loan Bank Board

Office of the Chairman

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

August 23, 1985
(As amended
September 4, 1985
and November 15, 1985

MEMORANDUM FOR: Principal Supervisory Agents

FROM: Edwin J. Gray
Chairman

SUBJECT: Directive Regarding Formal Enforcement Actions and Supervisory Agreements

As a follow-up to my memorandum of August 9, 1985, directing that we make vigorous use of the formal enforcement tools available to us, the following policies and procedures shall be effective immediately.

Principal Supervisory Agents ("PSA") shall have the responsibility for making recommendations for the initiation of formal examination proceedings (Section 407(m)(2) investigations) and formal enforcement actions (cease-and-desist proceedings, removal and/or prohibition actions, enforcement of existing orders, suits to enjoin violations of the Holding Company Act or Change in Control Act, etc.) for matters arising in their Districts. PSA's may delegate this responsibility within their own District as they feel appropriate, but shall be ultimately accountable for assuring that such recommendations are made swiftly and in the most expeditious manner possible.

Supervisory Agreements shall be written with precision, specification as to corrective actions or goals, and with clear, that is to say, precise deadlines established. Failure to comply with the material provisions of statutes, regulations, or Supervisory Agreements (including achievement of deadlines) shall be immediately reported in writing to the Bank Board. Notice of such non-compliance shall be accompanied by a written request for a cease-and-desist or other appropriate formal enforcement action or an explanation or valid reason why formal enforcement action is not sought.

All such notices of non-compliance and all recommendations for any formal investigation or enforcement action or requests for consideration and advice about possible enforcement proceedings, shall be in writing and are to be sent directly to the Director, Office of Enforcement for action. Copies of such notices and requests shall be sent simultaneously to the appropriate OES Assistant Director for Regional Operations ("ADRO") and to the Office of the Chief of Staff. Referrals that are made to the Office of Enforcement from other sources, such as the Corporate and Securities Division of OGC or other Bank Board offices and divisions, also shall be provided to the appropriate PSA, ADRO, and the Office of the Chief of Staff.

Any questions or conflicts about priorities for enforcement actions in a particular district shall be resolved by the PSA or his designee after consultation with the Director of the Office of Enforcement and the ADRO.

cc: Board Member Hovde
    Board Member Grigsby
    All Supervisory Agents
    Director, OES
    General Counsel

Exhibit 21

1700 G Street N W
Washington D C 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

Federal Home Loan Bank Board

EDWIN J. GRAY
CHAIRMAN

February 12, 1986

TO: Principal Supervisory Agents

FROM: Edwin J. Gray, Chairman

SUBJECT: Interim Examination Reports

Attached is a revised Interim Report Section of the Examination Objectives and Procedures (EOP) to the Directors of Examinations. Each Examiner-in-Charge shall make a prompt interim report to the Director of Examinations, who in turn should immediately forward the report to the Principal Supervisory Agent, whenever an examination uncovers information of significant nature that adversely affects an institution. This also includes the discovery of material violations of statutes and regulations and breaches of written agreements entered into by the institution and the Bank Board, the FSLIC, or other agents of the Federal Home Loan Bank Board.

In particular, special attention should be paid to the following:

- any failure to comply with conditions associated with the insurance of accounts by de novo institutions chartered in the last few years; and
- the failure of controlling parties at insured institutions to live up to contractual arrangements or agreements, such as net worth maintenance, personal guarantees, and acquisitions/assistance agreements with the FSLIC.

When the Principal Supervisory Agent receives an interim report of any failure to live up to de novo conditions or contractual agreements, including personal guarantees, the Principal Supervisory Agent will immediately forward five copies of the report to the Director of OES who will, in turn promptly refer copies to the Director of Enforcement, the Director of FSLIC, the General Counsel of the Board, and Chief of Staff of the Board.

Immediately upon the receipt of an interim report of failure to live up to such de novo conditions or contractual agreements, including personal guarantees, the Principal Supervisory Agent shall initiate aggressive corrective action to resolve the adverse situation and promptly report his plans, in writing, to the Director of OES with a copy to the Chief of Staff of the Bank Board.

Of course, failure to comply with de novo conditions and failure to live up to contractual agreements are not the only serious problems requiring notification of Washington offices and necessitating immediate corrective action. The Principal Supervisory Agent shall transmit a copy of all interim reports to the Director of OES, and where distribution to other Washington office officials is appropriate, it should include in the transmittal additional copies for the OES Director to make that distribution.

This memorandum constitutes a directive to all Principal Supervisory Agents which is effective immediately. Please assure that all appropriate parties to the Supervision and Examination process are advised.

Attachment

cc: Professional Staff -
Examinations and Supervision
All FHLB Districts

Federal Home Loan Bank Board

1700 G Street, N.W.
Washington, D.C. 20552

Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

OFFICE OF EXAMINATIONS AND SUPERVISION

February 12, 1986

TO: Directors of Examinations

FROM: Francis M. Passarelli, Acting Director

SUBJECT: Interim Reports

It is important that examiners report any serious problems as soon as they become aware of them, so that we can take timely and effective supervisory action to correct them. Too often, problems that examiners uncover remain buried in examination reports until the examination is transmitted to supervision.

Examination Objectives and Procedures (EOP) Section 004-4 describes the use of interim reports. Because many serious problems have not been called to the attention of Supervisory Agents through interim reports, we have rewritten this EOP section effective immediately to make clear that Examiners-in-Charge must make a prompt interim report through the Director of Examinations to the Principal Supervisory Agent whenever an examination uncovers significant information that will affect an institution adversely.

This also includes the discovery of material violations of statutes and regulations and breaches of written agreement entered into by the institution and the Bank Board, the FSLIC, or other agents of the Federal Home Loan Bank Board.

In particular, special attention should be paid to:

- the failure to comply with conditions associated with the insurance of accounts by de novo institutions chartered in the last few years; and

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- the failure of controlling parties at insured institutions to live up to contractual arrangements or agreements, such as net worth maintenance, personal guarantees, and acquisitions/assistance agreements with the FSLIC.

This EOP section is effective immediately. I know you will see that it is implemented.

A copy of the revised EOP section is attached.

Attachment

cc: Examination Staff
Supervisory Agents

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SECTION: MONITORING: EXAMINATION REPORTS **Page One**

SUBJECT: INTERIM EXAMINATION REPORTS

I. **INTRODUCTION** During the course of an examination, examiners may discover the deterioration of previously serious problems and/or the development of significant new problems or weaknesses. Examiners-in-Charge are expected to use interim reports to alert Field Managers, Directors of Examinations, Supervisory Agents, and OES Assistant Directors for Regional Operations to these problems and to solicit instructions, if any, from the Director of Examinations or Supervisory Agent for the scope of the examination or additional information that should be collected. Interim reports are also appropriate at the completion of an examination in order to expedite communication with the Supervisory Agent if the normal process of examination transmittal would not be sufficiently timely to alert the Supervisory Agent to a serious problem or weakness.

II. **OBJECTIVES** The purpose of interim reports is to provide a prompt alert to Supervisory Agents and others as to the problems that may need expeditious supervisory attention. Interim reports also:

- Provide the opportunity for Field Managers and Directors of Examination to request that the scope of the examination be expanded.
- Assist Supervisory Agents in deciding whether supervisory action should be initiated prior to the completion of an examination and whether additional specific examination procedures should be requested.
- Request Supervisory Agents to evaluate problems or weaknesses.

III. PROCEDURES A. When to Make an Interim Report

Interim reports are mandatory in the following circumstances:

1. When, in the judgment of the Examiner-in-Charge and/or the Field Manager, significant information has come to light indicating that the institution is adversely and significantly affected. Among the problems that have been of special concern to the Board in the recent past have been:
   - The failure to comply with conditions associated with the insurance of accounts by de novo institutions chartered in the last few years;
   - the failure of controlling parties at insured institutions to live up to contractual arrangements or agreements, such as net worth maintenance, personal guarantees, and acquisitions/assistance with the FSLIC; and
   - other statutory or regulatory violations, or unsafe or unsound conditions.
2. When, in the judgment of the Examiner-in-Charge and/or the Field Manager, there are additional, significant developments in a matter about which an initial interim report has been filed.
3. In response to requests from a District Director or Supervisory Agent for additional information on a matter about which an initial interim report has been filed.
4. Whenever an examination of an institution with less than $500 million in assets exceeds 30 calendar days; and whenever an examination of an institution with $500 million or more in assets exceeds 60 calendar days; additional interim reports should be filed each 30 calendar days until the completion of the examination.

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Examiners-in-Charge should use their judgment; there may be other circumstances in which interim reports are appropriate.

B. Flow of Information

Interim reports may be initiated by the Examiner, the Examiner-in-Charge, or the Field Manager to the Director of Examinations, who will then communicate with the Principal Supervisory Agent.

- Oral Reports. In order to assure that interim reports are timely, initial interim reports will usually be made orally (by telephone or in person) from the Director of Examinations, or other examination staff as the Director delegates, to the Principal Supervisory Agent or delegate. If possible, the Examiner-in-Charge or other examiner most familiar with the problems should participate in the call or meeting between the Director of Examinations and the Principal Supervisory Agent. Telephone calls and meetings should be followed by a memorandum, written by the examiner or Examiner-in-Charge, summarizing the oral report.

- Written Reports. The Director of Examinations should send all written reports to the Principal Supervisory Agent who in turn will send a copy to the Director of the Office of Examinations and Supervision (to the attention of the appropriate Assistant Director for Regional Operations) with the appropriate number of copies for distribution to other Board offices in Washington.

C. Content of Reports

Interim reports should not be formal. All interim reports should, of course, identify the institution by name and docket number, identify the examination, and describe the unacceptable condition or practice. The primary concern is with prompt communication, not format.

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The content of interim reports may vary from a brief outline of problems encountered to fully developed and substantiated conclusions. They may, for example: contain a description of the scope of the examination as of the date of the report; contain, as necessary, relevant financial statements, supporting data and analyses to facilitate understanding of the problem; indicate any remedial procedures utilized or planned by the institution; request guidance for proceeding with the examination; and/or make recommendations for supervisory action.

It is important that the interim report be timely. Therefore, the initial interim report should be made as soon as possible after the problem has been discovered, even if the examiner's conclusions are not yet fully developed or substantiated.

Subsequent interim reports should transmit in a timely manner all information necessary for the Supervisory Agent to take appropriate supervisory action.

IV. Supplemental Information

Instructions to Principal Supervisory Agents for their handling of interim reports are provided in a February 1986 memorandum from Chairman Edwin J. Gray, entitled "Interim Examination Reports."

Exhibit 2

DEPARTMENT OF THE TREASURY
WASHINGTON

MAR 11 1986

Dear Mr. Passarelli:

Enclosed are guidelines for examiners to use when reviewing retained copies of Currency Transaction Reports (Forms 4789). The guidelines, developed jointly with IRS, also provide instructions for examiners to use when requiring financial institutions to file amended or corrected reports. Please incorporate these guidelines into procedures used by examiners at your earliest convenience.

Sincerely,

David D. Queen
David D. Queen
Deputy Assistant Secretary
(Enforcement)

Mr. Frances M. Passarelli
Acting Director
Division of Examination & Supervision
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, D.C. 20552

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OFC OF EXAMS
& SUPVN.
F.H.L.B.B.

GUIDELINES FOR REVIEWING RETAINED COPIES OF CURRENCY TRANSACTION REPORTS FILED BY FINANCIAL INSTITUTIONS

Background

Examiners performing examinations of financial institutions for compliance with the provisions of 31CFR Part 103, are required to inspect retained copies of CTR's for accuracy and completeness. Personnel of financial institutions should also be instructed by examiners in the proper method of completing and filing the form. The IRS, in processing the forms, edits all CTRs filed for accuracy and completeness. When certain critical information is incomplete, illegible or is not provided, IRS corresponds with the financial institution to obtain the information.

Purpose

The purpose of these guidelines is to establish uniform examination procedures for the various financial institution supervisory agencies. The guidelines provide specific items of concern in reviewing CTRs, instructing financial institution personnel, and requiring amended or corrected reports to be filed.

General Procedures

o Use the instructions on the reverse side of the CTR and the supplemental instructions in IRS Publication 1145 (Revised 4/81)to provide guidance in proper completion of the form.

o Encourage financial institutions to type or legibly print forms.

o Insure that CTR correspondence from IRS has been correctly answered. Request copies of IRS CTR correspondence not associated or attached to CTR's being reviewed.

The IRS may correspond with the financial institution when one or more of the critical information elements as specified in the attachment is incomplete, illegible, or not provided. The correspondence is sent to the officer in charge of the financial institution at the address location indicated in Part V of the CTR. Insure that responses are made timely (within 10 days).

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o Request copies of any correspondence with IRS relating to incorrect or incomplete CTRs.

Require an amended or corrected form to be filed as follows:

1. If the form was not corrected as a result of correspondence from the IRS.
2. If (in the absence of IRS correspondence) the form does not adequately provide critical information as indicated in the attachment.

o Amended Form Instruction

1. On a copy of the CTR originally filed, circle in red the incorrect, illegible or missing information.
2. On a clean CTR, enter "AMENDED" or "CORRECTED" at the top margin above the Currency Transaction Report legend.
3. Enter only the correct or amended information on the clean form in the appropriate line item or box.
4. Sign and date the amended or corrected form.
5. Staple the amended or corrected form on top of the copy of the originally filed form.
6. Mail to the IRS Data Center, P.O. Box 32621, Detroit, MI 48232 ATTN: CTR Processing.

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CRITICAL INFORMATION ELEMENTS ON THE CURRENCY TRANSACTION REPORT

The IRS Data Center may correspond with a financial institution to obtain correct information when the following data elements are illegible, incorrect or not provided on the CTR.

Part I.

a. If none of the items in Part I are completed and there is no indication that the transaction was a night deposit, mail deposit/shipment or a multiple transaction.

b. If name, address, city, state or zip code is incomplete, illegible or not provided.

c. If a nine-digit social security number is not provided, is incomplete or illegible and the individual is conducting the transaction for himself or herself. (A SSN is not required if the individual is conducting the transaction for another person).

d. If the method of verifying identification is illegible, incomplete or not provided. Statements such as "known customer" or "known to us" are not sufficient. Financial Institution should obtain the required data on known customers from account records, signature cards etc.

e. If the Part I person is other than an individual. (Exception: Names of armored car service companies are acceptable).

Part II

a. If name, and address is incomplete, illegible or not provided, except when the individual in Part I is conducting the transaction for himself or herself.

b. If a nine-digit TIN (employer's identification number or social security number) is not provided, or is illegible. The box for TIN should contain the word "NONE" if the customer is a foreign person who has no TIN.

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Part III

a. If the nature of the transaction in Part IV effects a customer's account (e.g. deposit, withdrawal) and the account number is illegible or not provided.

Part IV

a. If an appropriate box in item 1 is not checked.

b. If item 2, 3, or 4 is not completed or is illegible.

c. If the nature of the transaction is a check purchased or check cashed and the information in item 6 is incomplete, illegible or not provided.

Part V

a. If the name and address of the financial institution is illegible or not completed.

b. If the TIN (EIN or SSN) is not 9-digits or is otherwise incorrect or not provided.

c. Central compliance office addresses are not acceptable.

> Note: An amended form requiring the change of only this element should not be submitted. However, if an amended form is required for one of the other critical elements, this element should also be corrected.

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Exhibit 23

Internal Revenue Service Department of the Treasury

Washington DC 20224

DEC 2 3 1985

Francis M. Passarelli, Acting Director
Division of Examination & Supervision
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, DC 20552

Dear Mr. Passarelli:

During the December 4 Bank Secrecy Act (BSA) meeting, it was decided that IRS provide the Form 4789 (CTR) is returned to the financial institution for proper completion. Enclosed is a CTR (in current use until June 30, 1986) which denotes those critical elements.

The form is returned when these critical fields are either missing or illegible. The fields which are shown with an asterisk are researched by our personnel rather than using correspondence to perfect the document (i.e., zip codes and branch address where the transaction took place). We feel this is presently the most effective way of perfecting this data. It would be appreciated if proper completion could be reinforced during your agency examinations. Your compliance efforts should not be reduced as to proper completion of the entire form. Yet, until we can reduce the backlog of documents, we will limit our correspondence to these items.

This should provide the information you desire.

If you should have any questions concerning this matter, please contact Ryan Corrigan at 566-3098.

Sincerely,

Brian M. Bruh
Director, Office of Investigations
(Criminal Investigation)

Enclosure

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Part I	1,2	Name
	3	SSN
	4	Address
	5,6	City, State (if US, CA or MX)
	7	Country (other than US, CA, MX)
	8	Identifying number present on document The number can be an SSN (#3) or Valid pasaport, alien ID or driver's permit number (#8)
Part II	9	Name
	10	Missing EIN (if state in number 13 w is in U.S.)
	11	Address
	12, 13	City, State (if US, CA or MX)
	14	Country (other than US, CA or MX)
Part III	15	An account number is missing and the Nature of Transaction in Part 4 is a Deposit, Withdrawal or a Night/Mail Deposit.
Part IV	16	The Nature of Transaction is not present in the document
	17	There is no currency transaction amount on document
	18	The date of transaction is missing
Part V	19	The EIN is missing
	20	The document is not signed

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Form 4789
(Rev. December 1983)
Department of the Treasury
Internal Revenue Service

Currency Transaction Report

File a separate report for each transaction
(Complete all applicable parts—see instructions)

OMB No. 1545-0183
Expires 12-31-85

Part I Identity of individual who conducted this transaction with the financial institution

Name (Last) ① ②	First	Middle initial	Social Security Number ③ ③
Number and Street ④			Business, occupation, or profession
City ⑤	State ⑥	ZIP code *	Country (if not U.S.) ⑦

Method of verifying identification: ⑧
☐ Driver's permit .... (State) .... (Number)
☐ Alien ID card .... (Country) .... (Number)
☐ Passport .... (Country) .... (Number)
☐ Other (specify) ....

Part II Individual or organization for whom this transaction was completed (Complete only if different from Part I)

Name ⑨			Identifying number ⑩
Number and Street ⑪			Business, occupation, or profession
City ⑫	State ⑬	ZIP code *	Country (if not U.S.) ⑭

Part III Customer's account number ⑮

☐ Savings account .... (Number)
☐ Checking account .... (Number)
☐ Share account .... (Number)
☐ Loan account .... (Number)
☐ Safety deposit box .... (Number)
☐ Other (specify) ....

Part IV Description of transaction. If more space is needed, attach a separate schedule and check this box ☐

1. Nature of transaction (check the applicable boxes) ⑯
☐ Deposit
☐ Withdrawal
☐ Check Cashed
☐ Check Purchased
See item 6 below
☐ Currency Exchange
☐ Mail/Night Deposit
☐ Other (specify)

2. Total amount of currency transaction (in U.S. dollars) ⑰	3. Amount in denominations of $100 or higher	4. Date of transaction (Month, day, and year) ⑱

5. If other than U.S. currency is involved, please furnish the following information:

Currency name	Country	Total amount of each foreign currency (in U.S. dollars)

6. If a check was involved in this transaction, please furnish the following information (See instructions):

Date of check	Amount of check (in U.S. dollars)	Payee
Drawer of check		Drawee bank and City

Part V Financial institution reporting the financial transaction

Name and Address ADDRESS # * ZIP *	Identifying number (EIN or SSN) ⑲
	Business activity

Sign here ▶ ⑳ .... (Authorized Signature) .... (Title) .... (Date)

Type or print name of authorized signer ▶

For Paperwork Reduction Act Notice, see the back of this page.

General Instructions

Paperwork Reduction Act Notice.—The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us.

The requested information is useful in criminal, tax, and regulatory investigations. In addition to directing the Federal Government's attention to unusual or questionable transactions, the reporting requirement discourages the use of currency in illegal transactions. Financial institutions are required to provide the information under 31 CFR 103.22, 103.25, and 103.26.

Who Must File.—Each financial institution must file a Form 4789 for each deposit, withdrawal, exchange of currency, or other payment or transfer, by, through, or to that financial institution, which involves a transaction in currency of more than $10,000. Multiple transactions by or for any person which in any one day total more than $10,000 should be treated as a single transaction, if the financial institution is aware of them.

Exceptions.—Banks do not have to file Form 4789 for transactions with Federal Reserve Banks, Federal Home Loan Banks, or other domestic banks.

Banks do not have to file Form 4789 for the following transactions if the amounts involved are reasonable and customary in the course of the customer's business or activities:

(1) deposits or withdrawals of currency from an existing account by an established depositor who is a U.S. resident and who—
  (a) operates a retail business in the United States (except automobile, boat, or airplane dealerships), or
  (b) operates a sports arena, race track, amusement park, bar, restaurant, hotel, licensed check cashing service, vending machine company, or theater;
(2) deposits or withdrawals, exchanges of currency, or other payments and transfers by local, state, or Federal government agencies;
(3) withdrawals for payroll purposes from an existing account by an established depositor who is a U.S. resident and who operates a firm that regularly withdraws more than $10,000 to pay employees in currency.

Banks must keep a record of customers whose transactions are not reported because of exceptions (1) through (3) above. (See 31 CFR, section 103.22 for details about what to include in this record.)

Nonbank financial institutions do not have to report transactions with commercial banks.

When and Where to File.—File this form by the 15th day after the date of the transaction with the Internal Revenue Service, Odgen, UT 84201, or hand carry it to your local IRS office. Keep a copy of each Form 4789 for 5 years from the date you file it.

Identifying Number.—For individuals this is the social security number. For others it is the Federal employer identification number (9 digits).

Identification Required.—Before completing a transaction, a financial institution must verify and record (1) the name and address of the individual making the transaction and (2) the identity, account number, and taxpayer identifying number (if any) of the individual or organization for whose account the transaction is being made. Use a passport or other official document showing nationality to verify the identity of an alien or nonresident of the United States. Use a document like a driver's license, etc., normally accepted as a means of identification when cashing checks, to verify the identity of anyone else. In each case, record on this form the method of identification used.

Penalties.—Civil and criminal penalties (up to $500,000) are provided for failure to file a report or to supply information, and for filing a false or fraudulent report. See 31 CFR, sections 103.47 and 103.49.

Specific Instructions

Part I.—

(1) In the address section, enter the permanent street address of the individual conducting the transaction. If the currency was received or shipped through the U.S. Postal Service, write in "U.S. Mail." If the currency was received in a night deposit box, write in "Night Deposit." If the currency was received or shipped through an armored car service, licensed by a state or local government, provide only the service's name and address.
(2) In the social security block, enter the social security number of the individual conducting the transaction. If the individual has no number, write "None" in this block.
(3) Check the appropriate box and enter the number of the document used to verify the identity of the individual making the transaction. When the name of an individual is not required to be given, it is not necessary to describe the method of verifying identification.

Part II.—

(1) For individuals, enter last name, first name, and middle initial, if any, in the name block in that order. For all others, enter the complete organization name.
(2) In the identifying number block, enter the social security number or employer identification number.

Part III.—

Check the appropriate box and enter the appropriate customer's account number. If there is no account relationship, check Other and write in "None."

Part IV, line 1.—

If the transaction being reported was the sale or purchase of foreign currency, check Other and write in "sale of foreign currency" or "purchase of foreign currency," whichever applies.

Part IV, line 6.—

Complete this line if a check is cashed or a bank check is purchased with currency.

Part V.—

Institutions may also enter in the name and address block other identifying information.

Signature.—This report must be signed by an authorized individual. Also type or print the name of the authorized signer.

Definitions

Bank.—Each agent, agency, branch, or office in the United States of a foreign bank and each agency, branch, or office in the United States of any person doing business in one or more of the capacities listed below:

(1) a commercial bank or trust company organized under the laws of any state or of the United States;
(2) a private bank;
(3) a savings and loan association or a building and loan association organized under the laws of any state or of the United States;
(4) an insured institution as defined in section 401 of the National Housing Act;
(5) a savings bank, industrial bank, or other thrift institution;
(6) a credit union organized under the laws of any state or of the United States; and
(7) any other organization chartered under the banking laws of any state and subject to the supervision of the bank supervisory authorities of a state.

Currency.—The coin and currency of the United States or of any other country, which circulate in and are customarily used and accepted as money in the country in which issued. It includes United States silver certificates, United States notes, and Federal Reserve notes, but does not include bank checks or other negotiable instruments not customarily accepted as money.

Financial Institution.—Each agency, branch, or office in the United States of any person doing business in one or more of the capacities listed below:

(1) a bank;
(2) a broker or dealer in securities, registered or required to be registered with SEC under the Securities Exchange Act of 1934;
(3) a person who engages as a business in dealing in or exchanging currency (for example, a dealer in foreign exchange or a person engaged primarily in the cashing of checks);
(4) a person who engages as a business in issuing, selling, or redeeming traveler's checks, money orders, or similar instruments, except one who does so as a selling agent exclusively, or as an incidental part of another business;
(5) a licensed transmitter of funds, or other person engaged in the business of transmitting funds abroad for others.

Person.—An individual, corporation, partnership, trust or estate, joint stock company, association, syndicate, joint venture, or other unincorporated organization or group, and all entities treated as legal personalities.

Transaction in Currency.—A transaction involving the physical transfer of currency from one person to another. A transaction in currency does not include a transfer of funds by means of bank check, bank draft, wire transfer, or other written order that does not include the physical transfer of currency.

Exhibit 24

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

MEMORANDUM SP - 31

FROM: D. James Croft

July 22, 1983

TO: OES Professional Staff

Currency and Foreign
Transactions Reporting
Act: also known as the
Bank Secrecy Act

SYNOPSIS: PROCEDURES FOR SECURING ASSOCIATION COMPLIANCE WITH THE SUBJECT ACT, INCLUDING COMPLETION OF A STATISTICAL COMPLIANCE REPORT, ARE PRESENTED BELOW.

Notes: (1) The procedures for securing association compliance presented in this SP memorandum are being transferred from the #A-386 series of memoranda. In addition, guidelines to be used in determining whether to recommend civil penalties are added -- as Attachment I.

(2) Memoranda #A-386, #A-386(a), #A-386(d) and #A-386(e) are hereby rescinded.

Introduction

Section 103.46(a)(3) of the Treasury Department's Financial Recordkeeping and Reporting of Currency and Foreign Transactions Regulations (31 CFR § 103.46(a)(3)) delegates to the Bank Board responsibility for assuring compliance with Part 103 of the Treasury Department's regulations implementing the subject Act by institutions whose accounts are FSLIC insured. Various of the requirements of the Act are explained in the #T-53 series of memoranda, and examindtion objectives and procedures pertaining to examiners' responsibilities in determining association compliance are presented in EOP manual section 129.

As with other regulations, examiners shall determine and report in examination reports regulatory violations, and Supervisory Agents shall take appropriate supervisory action necessary to obtain association compliance. However, on a newly insured or new Federally chartered association in which compliance is first being determined, unless there is an indication that the association was aware of the requirements and disregarded them to facilitate or conceal some other violation of law (e.g., to facilitate the evasion of taxes or conceal narcotic trafficking), it will normally be sufficient for an examiner to apprise management of its responsibilities under the regulation. These responsibilities, which also apply to older associations, include (1) establishing an adequate system for identifying transactions which the regulations cover and for insuring

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that they are properly reported, and (2) giving instructions to those employees who normally come into contact with the covered transactions as to their responsibilities with respect to the system. In addition, examiners should encourage associations to designate a compliance officer to (1) insure that the applicable recordkeeping and reporting requirements of the regulations are fully observed as well to (2) maintain liaison with the Supervisory Agent.

Statistical Compliance Report by District Directors

As a guide in determining association compliance with the regulations, pursuant to instructions contained in EOP manual section 129 examiners complete a Financial Recordkeeping and Reporting Regulations checklist identified as FHLBB Form 919. On the basis of these completed forms, District Directors shall for the semiannual periods ending June 30 and December 31 of each year prepare and submit (with a copy to the Supervisory Agent) to the OES Associate Director-Policy, Washington, D.C. a statistical compliance report containing the following information:

(a) approximate number of insured institutions examined during the period covered (can be number of completed FHLBB Form 919s received as contrasted to the number of examination reports completed);
(b) number and type of violations observed by examiners - clerical errors and oversights should not be included;
(c) number of reports of apparent violations received by OES from the Treasury Department or from other sources;
(d) number of cases referred to the Regional Director in which the assessment of civil penalties was recommended;
(e) number of cases referred to the Regional Director for possible criminal investigation; and
(f) comments on the need for modification of the regulations or on their value to the insured institutions or the Board.

For each violation reported pursuant to item (b) above, the District Director shall:

(1) identify the association by name and address (e.g., branch office) where the violation occurred;
(2) provide a description of the violation (e.g., by including a copy of the examiner's comment) and association corrective action promised or already taken; and
(3) send a copy of the examiner's completed FHLBB Form 919 which discloses the violation.

For violations reported pursuant to items (c), (d), and (e) above, the District Director is to identify the association and provide a description of the violation.

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Civil Penalty

Section 103.47(a) of the regulations authorizes the Treasury Department to assess for any willful violation of any requirement of the regulations a civil penalty upon a savings and loan association and upon any partner, director, officer or employee thereof. Attached to this memorandum for your guidance in determining whether to recommend the imposition of civil penalties is Attachment I, entitled, "Guidelines For Recommendations Concerning The Assessment Of Civil Penalties Against Financial Institutions And Individuals Associated With Such Institutions." These guidelines were prepared by the Treasury Department and are dated June 16, 1983.

Criminal Penalty

Section 103.49 of the regulations provides for the imposition of a criminal penalty. Attached to this memorandum for your guidance is Attachment II, entitled, "Guidelines For Referral to The Treasury Department For Possible Criminal Investigation Regarding Violations Of The Bank Secrecy Act." These guidelines are based on material the Treasury Department sent to us in 1973.

Reference should also be made to Memorandum #T 53-6 concerning recommendations of civil and criminal penalties.

D. James Croft

D. James Croft
Director

Attachments

ATTACHMENT

GUIDELINES FOR RECOMMENDATIONS CONCERNING THE ASSESSMENT OF CIVIL PENALTIES AGAINST FINANCIAL INSTITUTIONS AND INDIVIDUALS ASSOCIATED WITH SUCH INSTITUTIONS

I. PURPOSE

This document sets forth certain guidelines for recommendations concerning the assessment of civil penalties against financial institutions pursuant to 31 C.F.R. § 103.47(a). These guidelines are intended to assist those agencies responsible for assuring compliance with the requirements of the Bank Secrecy Act in determining whether to recommend to the Department of the Treasury that it assess civil penalties for violations of the Act.

II. REFERENCE

Title I, Chapter 2 of Pub. L. 91-508, 84 Stat. 1116 (October 26, 1982), (codified at 12 U.S.C. §§ 1951-1959), and the Currency and Foreign Transactions Reporting Act (Title II of Pub. L. 91-508, 84 Stat. 118, (October 26, 1982), permanently codified at 31 U.S.C. §§ 5311 *et seq*. by Pub. L. 97-258, 96 Stat. 877 (Sept. 13, 1982); hereinafter referred to as the Bank Secrecy Act), and the implementing regulations, as amended (31 C.F.R. Part 103), authorize the Secretary of the Treasury to assess civil penalties against financial institutions and associated individuals that violate the requirements of the Bank Secrecy Act. (*See* 31 U.S.C. § 5321, and 31 C.F.R. § 103.47(a).) The Assistant Secretary (Enforcement and Operations) has been authorized to exercise this authority. *See* Treasury Department Order No. 101-5 (Dec. 21, 1981).

Under the regulations implementing the Bank Secrecy Act (31 C.F.R. § 103.46(b)), the Assistant Secretary (Enforcement & Operations) has been assigned the overall responsibility for the administration and coordination of enforcement of the Bank Secrecy Act regulations. The responsibility for assuring compliance with the regulations by specific financial institutions has been assigned to the Federal financial institutions supervisory agencies, the Securities Exchange Commission, the Internal Revenue Service and the U.S. Customs Service (31 C.F.R. § 103.46(a)).

III. GUIDELINES

The assessment or threat of assessment of a civil penalty can provide a significant deterrent to non-compliance with the Bank Secrecy Act regulations and can provide the flexibility to insure that financial institutions continue to comply with the provisions of those regulations. In order to assure compliance with the Bank Secrecy Act, the Assistant Secretary (Enforcement and Operations) will consider the assessment of civil penalties based on recommendations received pursuant to these guidelines.

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A. Examination and Supervisory Procedures

1. Each agency delegated responsibility under 31 C.F.R. § 103.46(a) for assuring compliance with the Bank Secrecy Act regulations shall be responsible for identifying violations of the regulations by financial institutions and associated individuals. Whenever the agency determines that a civil penalty would be an appropriate sanction, it shall refer the matter to the Assistant Secretary (Enforcement & Operations) for the assessment of a civil penalty.

2. Each agency delegated responsibility under 31 C.F.R. § 103.46(a) for assuring compliance with the Bank Secrecy Act regulations shall provide the Assistant Secretary (Enforcement and Operations) with a report on the procedures it has in place for instituting and conducting compliance examinations. In addition, each agency shall inform the Assistant Secretary (Enforcement & Operations) of any subsequent changes in its examination procedures.

These guidelines do not affect an agency's examination procedures and are not intended to impose any additional examination procedures.

B. Agency Referals

When referring a violation of the Bank Secrecy Act regulations to the Assistant Secretary (Enforcement and Operations) for the assessment of a civil penalty, the referring agency shall set forth the facts indicating that the violation was willful */ and that it has one or more of the following characteristics:

1. The violation was flagrant or in some way showed bad faith on the part of the financial institution or individual(s) who participated in the violation.

2. The violation directly or indirectly involves an insider or an associate of an insider who benefited or could have benefited from the transaction in a material/substantial way when the insider knew or should have known the requirements of the law.

3. A previous civil penalty review Supervisory Letter or other previous written notification of a violation(s) has been issued to the financial institu-

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*/ The term "willful" means actions taken by individuals involved in the violation "knowingly", "consciously", or "intentionally".

tion. The term "other previous written notification of violation(s)" means written notification to the financial institution by Treasury, the Federal financial institutions supervisory agencies, IRS, SEC, or the Customs Service as a result of a compliance examination.

4. A criminal investigation of a violation has been completed and either (1) a criminal penalty has been imposed, or (2) no criminal penalty has been imposed but any or all of the criteria in 1, 2 and 3 above are present.

5. The violation is of sufficient gravity to warrant the imposition of a civil penalty. The following factors are considered relevant when determining the gravity of the violation:

   (1) evidence that the violation or pattern of violations was committed with a disregard for the law or the consequences to the institution;

   (2) the frequency or recurrence of violations and the length of time the violation has been outstanding;

   (3) continuation of a violation after the financial institution becomes aware of it;

   (4) the immediate cessation and correction of a violation after the violation was discovered;

   (5) failure to cooperate with the agency to effect an early resolution and correction of the violation;

   (6) evidence of concealment or voluntary disclosure of the violation;

   (7) evidence that participants or their associates received financial or other gain or benefit or preferential treatment as a result of the violation;

   (8) evidence that the violation facilitated or concealed or may have facilitated or con-

cealed illegal activity by the financial institution, its employees, its customers, or others;

(9) history of prior violations particularly where similarities exist between those and the violation under consideration;

(10) previous written criticism of the institution for similar violations;

(11) presence or absence of a compliance program and evidence of its effectiveness;

(12) the existence of prior agreements, commitments or orders intended to prevent the subject violation.

The agency shall include in its referral any documentation that supports its recommendation that a civil penalty be assessed.

Whenever the Assistant Secretary (Enforcement & Operations) receives a referral from an agency requesting the assessment of a civil penalty, the Assistant Secretary or his designee may issue a written notice of the violation(s) to the financial institution and/or individual(s). Such written notice would serve as notice to the financial institution and/or individual(s) that the matter is being considered by the Department of the Treasury for assessment of a civil penalty. An example of such written notification is set forth as an Attachment to these Guidelines.

C. Assessment of Civil Penalties based on Agency Referrals

Consistent with the provisions of 31 C.F.R. § 103.47(a) the Assistant Secretary (Enforcement & Operations) or his designee, shall review all referrals recommending the assessment of civil penalties against financial institutions and individuals associated with those financial institutions.

If the Assistant Secretary (Enforcement and Operations) or his designee finds that additional documentation is necessary to support the recommendations in the agency referral, he may request such documentation from the agency.

After completion of his review and after review by the Office of the General Counsel, the Assistant Secretary (Enforcement and Operations) or his designee shall:

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(1) Assess a civil monetary penalty against the financial institution or individual(s) or both; or

(2) Issue a civil penalty supervisory letter to the financial institution or individual(s) or both.

(3) Initiate a criminal investigation; or

(4) Inform the financial institution or individual(s) or both that no civil penalty will be assessed.

A report of the final action taken by the Assistant Secretary (Enforcement and Operations) or his designee shall be made to the referring agency.

D. Compromise

The Assistant Secretary (Enforcement and Operations) has the discretion to compromise, modify or remit any recommended penalty and to compromise, modify or remit any penalty assessed under 31 C.F.R. § 103.47(a).

Attachment

DATED: JUN 16 1983

APPROVED:

Robert E. Powis
Deputy Assistant Secretary
(Enforcement)

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Attachment A

SAMPLE NOTICE TO FINANCIAL INSTITUTION OF SPECIFIC VIOLATIONS OF 31 CFR PART 103

Dear Mr. (Principal Executive Officer)

An examination of your organization by (compliance agency) pursuant to the provisions of 31 CFR Part 103 was conducted for the period of ______________________.

The examination resulted in the discovery of the following specific violations of the recordkeeping and reporting requirements of 31 C.F.R. Part 103:

1.

2.

3.

These violations are considered to be significant and serious and have been referred to this office for review and consideration of the assessment of a civil penalty.

If you believe that assessment a civil penalty is unwarranted, you may respond to the Deputy Assistant Secretary (Enforcement) U.S. Treasury Department, 15TH & Pennsylvania Avenue, N.W., Room 4308, Washington, D.C. 20220, within 30 days from the date of this letter. Your response should be in writing and should address each of the violations cited above stating the circumstances you believe preclude the imposition of a civil penalty. You may also submit documentary evidence or other written evidence to support your contentions. Your response should also indicate actions your organization intends to implement to correct the violations and to preclude such violations in the future.

Sincerely,

____
Deputy Assistant Secretary
(Enforcement)

Principal Executive Officer
Title
Name of Organization
Address of Organization

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ATTACHMENT II

GUIDELINES FOR REFERRAL TO THE TREASURY DEPARTMENT FOR POSSIBLE CRIMINAL INVESTIGATION REGARDING VIOLATIONS OF THE BANK SECRECY ACT

Whenever there is evidence that an association is deliberately disregarding the provisions of Part 103 of the Treasury Department Regulations in a attempt to conceal or abet a violation of the regulations or some other law or regulation, or to conceal a customer's transaction (e.g., the laundering of currency), the examiner or District Director, in conjunction with the Supervisory Agent, is to immediately report the facts involved to the Regional Director for processing to the Treasury Department for possible criminal investigation (Section 103.49). In addition to being reasonably sure that association management had prior knowledge of the regulations, one or more of the following conditions should be present before the District Director and Supervisory Agent refer the case to the Regional Director for referral (with the concurrence of the OES Director) to the Treasury Department for criminal investigation:

(1) records required under the regulations are being retained for an unusually short period of time as compared with the retention period requirements of the regulations and other industry standards;

(2) records pertaining to the accounts of one or small group of individuals are incomplete and the association's explanation is not plausible;

(3) records are missing under mysterous circumstances;

(4) a required report of international transportation of currency or other monetary instruments has intentionally not been filed;

(5) a list is not being maintained of the names, addresses, and account numbers of those entities whose identification numbers the association is unable to secure; or

(6) any other regulatory violation under circumstances that are suspicious and of such a nature of indicate that a criminal investigation may be warranted.

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Exhibit 25

FEDERAL HOME LOAN BANK BOARD

OFFICE OF EXAMINATIONS AND SUPERVISION

MEMORANDUM AB- 66

TO: Professional Staff -
Examinations and Supervision

February 11, 1986

FROM: Francis M. Passarelli

SUBJECT: Bulletin PA-7a-3

SYNOPSIS: AMENDMENT OF BULLETIN PA-7a-3 IN PROCESS

Bulletin PA-7a-3 includes language that is too broad to adequately and effectively convey the guidance to the independent public accountants that was intended by this office. Therefore, an amended Bulletin is in process of being prepared that will better direct the attention of the accountants to the required audit work relative to the detection and reporting of money laundering activities. which is the area we specifically want them to concentrate on. While an exact date has not yet been established, the amended Bulletin PA-7a-3 will be released in the near future. Until the amended Bulletin is available, any questions should be directed to Deputy Director Robert J. Moore, (202) 377-6480.

Francis Passarelli
Acting Director

Distribution to State supervisory authorities to be made by Director of Examinations.

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Exhibit 26

FEDERAL HOME LOAN BANK BOARD

12 CFR Parts 563, 574, 584 and 589

[No. 85-1005]

Acquisitions of Control of Insured Institutions

Dated November 8, 1985.

AGENCY: Federal Home Loan Bank Board.

ACTION: Final rule.

SUMMARY: The Federal Home Loan Bank Board is amending its regulations implementing the statutory provisions governing the acquisition of control of thrift institutions chartered by the Federal Home Loan Bank Board or whose accounts are insured by the Federal Savings and Loan Insurance Corporation. These regulations are collected in a single new part of the Code of Federal Regulations in order to better coordinate the provisions of the Change in Savings and Loan Control Act, 12 U.S.C. 1730(q) (1982), and the Savings and Loan Holding Company Act, 12 U.S.C. 1730a (1982). In brief, the regulations:

—Eliminate the overlap in the application of the Savings and Loan Holding Company Act and the Change in Savings and Loan Control Act and clarify the acquisitions covered by each statute;

—Clarify and provide consistent definitions under both statutes for key terms such as "control," "company," "acting in concert," "person," and "voting stock;"

—Define specifically what constitutes the acquisition of control and minimize uncertainty as to when an application or notice is required;

—State situations which give rise to rebuttable determinations of control and how an acquiror may attempt to rebut these determinations;

—Establish specific presumptions for when persons or companies will be considered to be acting in concert to acquire control of an insured institution, in order to better enable the Board to address acquisitions of control by groups acting in concert;

—Require certifications regarding 10 percent ownership of insured institutions' stock, so that the Board and its staff will be able to examine who are the ultimate owners of insured institutions;

—Clarify, streamline and expedite various applications procedures;

—Provide a uniform type of public notice for holding company applications and change in control notices, including an opportunity for target institutions to register their objections, if any, to the acquisition, as part of the Board's application review process, thereby providing the Board with more information concerning potential acquirors;

—Specify "presumptive disqualifiers" that would put prospective acquirors on notice of factors that would raise concerns about their qualifications to acquire control of an insured institution;

—Implement an enhanced system of delegations, particularly to the Principal Supervisory Agents, including the ability to deny the applications that the Principal Supervisory Agents have delegated authority to approve, thereby speeding up the application process; and

—Provide, overall, a cohesive regulation that furnishes the specific guidance on key issues which is necessary in order to fairly and effectively implement increased use of delegations and promote efficient utilization of the Board's resources.

EFFECTIVE DATE: December 26, 1985.

FOR FURTHER INFORMATION CONTACT: R. Penfield Starke, Attorney (202/377-6453), Laura Patriarca, Deputy Director for Corporate (202/377-6411), or Julie L. Williams, Associate General Counsel, Director (202/377-6459), Corporate and Securities Division, Office of General Counsel, Federal Home Loan Bank Board, 1700 C Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION: By Resolution No. 85-289a, dated April 17, 1985, the Federal Home Loan Bank Board ("Board"), as operating head of the Federal Savings and Loan Insurance Corporation ("Corporation or FSLIC"), proposed extensive revisions to its regulations implementing the statutory restrictions on the acquisitions of control of stock form thrift institutions chartered by the Board or whose accounts are insured by the Corporation. *Acquisitions of Control of Insured Institutions*, 50 FR 18274 (April 25, 1985). The proposal would have revised the Board's regulations implementing the Change in Savings and Loan Control Act, 12 U.S.C. 1730(q) (1982) (the "Control Act") and the acquisition provisions of the Savings and Loan Holding Company Amendments of 1967, 12 U.S.C. 1730a (1982) (the "Holding Company Act") (collectively the "Acts"). The proposed revisions were intended to better adapt the Board's rules to the acquisition practices that have become prevalent in the thrift industry while at the same time streamlining the application process by codifying the Board's past interpretations of its rules, increasing the use of delegated authority and otherwise avoiding unnecessary delays in the acquisition review process.

General

A. Background

Acquistions of control of stock form institutions chartered by the Board or whose deposits are insured by the Corporation are generally governed by either the Control Act or the Holding Company Act.[1] Both of these statutes specifically authorize the Board to issue rules and regulations to carry out their purposes. 12 U.S.C. 1730(q)(14), 1730a(h)(1) (1982). The Holding Company Act prohibits any "company," directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, or through one or more transactions, from acquiring control of one or more insured institutions without the prior written approval of the Corporation. 12 U.S.C. 1730a(e)(1)(B) (1982). For purposes of this restriction, the term "company" is broadly defined to include any corporation, partnership, trust, joint-stock company or similar organization, except those controlled by the United States or any State or an officer or instrumentality thereof. *Id.* at 1730a(a)(1)(c). The Control Act applies to acquistions that are not subject to the Holding Company Act. 12 U.S.C. 1730(q)(17) (1982). It prohibits any "person," acting directly or indirectly or through or in concert with one or more persons, from acquiring control of an insured institution through a purchase, assignment, transfer, pledge, or other disposition of the "voting stock" (which includes rights and powers with respect thereto), of the institution unless the Corporation has been given sixty days' prior notice and has not objected. *Id.* at 1730(q)(1). Under both Acts, insured institutions include state and federally chartered thrift institutions whose accounts are insured by the Corporation and federally chartered savings banks whose accounts are insured by the Federal Deposit Insurance Corporation, and holding companies thereof. 12 U.S.C. 1730(q)(13)(B), 1730a(a)(1)(A) (1982).

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[1] Acquisition of control by a company of a mutual form institution also is subject to the Holding Company Act. However, the Holding Company Act prohibits a savings and loan holding company from holding, soliciting, or exercising any proxies in respect to any voting rights in an insured institution which is a mutual institution. 12 U.S.C. 1730a(e)(1) (1982). The Board's Office of General Counsel has interpreted this provision as having the effect of prohibiting a company from acquiring control of a mutual insured institution. *See* Op. G.C. July 20, 1970. Also, in this regard, the Board's other regulations currently prohibit the designation of "any corporation or partnership (including any person acting on behalf of a partnership) as the holder of a proxy of a mutual insured institution." *See* 12 CFR 569.3(b) (1985). Because a company is precluded from acquiring control of a mutual institution, the Board does not intend the provisions of the Holding Company Act and the regulations adopted today to be applicable to a mutual insured institution.

An individual is not prohibited from acquiring control of a mutual insured institution under the Control Act. The Board has provided regulations which govern the acquisition of control of a mutual insured institution at 12 CFR 563.18-1 (1985). Thus the regulations adopted today are not applicable to the acquisition of control of a mutual insured institution by an individual.

Both statutes employ expansive definitions of control. In the Control Act, the term connotes the power, directly or indirectly, to direct the management or policies of an insured institution. 12 U.S.C. 1730(q)(8)(B) (1982). The Holding Company Act provides that the term includes control in any manner of the election of the majority of the directors of an insured institution. 12 U.S.C. 1730a(a)(2)(A) (1982). Control may also be found under the Holdsing Company Act if the Corporation determines that a person, directly or indirectly, exercises a controlling influence over the management or policies of an insured institution. *Id.* at 1730a(a)(2)(D). And under either statute, control is conclusively determined to exist upon the acquisition of the power to vote more than 25 percent of the voting shares or securities of an insured institution. 12 U.S.C. 1730(q)(8)(B); 1730a(a)(2)(A) (1982).

The Holding Company Act gave the Board comprehensive authority over savings and loan holding companies and their subsidiaries and was intended to guard against the potential conflicts of interest that can occur in the holding company structure. S. Rep. No. 354, 90th Cong., 1st Sess. 1–2 (1967). The holding company regulatory system involves registration and examination of holding companies, and limitations on transactions between an insured institution and its affiliates in a holding company structure, in addition to the prior approval of acquisitions of insured institutions by companies.

The Control Act is more limited in scope, having been adopted to close a "glaring gap" in the jurisdiction of the federal agencies regulating financial institutions,[1] namely, the uncertain applicability of the Holding Company Act to acquisitions by individuals and groups of individuals who did not constitute a "company." H.R. Rep. No. 1383, 95th Cong., 1st Sess. 19 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 9291. Its primary purpose was to give the agencies more authority to scrutinize the qualifications of individuals seeking to acquire control of existing financial institutions. As noted in the resolution in which the Control Act regulations were first promulgated, the Corporation's objectives in administering the Control Act "are to enhance and maintain public confidence in the savings and loan industry by preventing serious adverse effects resulting from anticompetitive combinations of interests, inadequate financial support, or unsuitable management of these institutions." *Amendments Relating to the Change in Savings and Loan Control Act of 1978*, Board Resolution No. 79-121, 44 FR 10500 (Feb. 21, 1979).

Notwithstanding their differences, both statutes reflect a congressional concern with the qualifications of acquirors of insured institutions and serve the same goal of preventing the acquisition of influence over the management and policies of insured institutions in circumstances that might result in injury to the institution, its depositors, or the insurance risk of the FSLIC. Accordingly, the statutes interact to form a comprehensive regulatory framework for acquisitions of control of insured institutions. If the acquiror is a "company," as defined, the acquisition of control is subject primarily to the Holding Company Act. All other control acquisitions would involve the Control Act.

Notwithstanding the commonality of provisions and purpose between the Acts, the Board's implementing regulations have developed along separate paths. The Regulations for Savings and Loan Holding Companies, 12 CFR Parts 583–589 (1985), originally were promulgated in Board Resolution No. 21,400, 33 FR 3322 (Feb. 22, 1968), immediately following the adoption of the Holding Company Act in its current form in the Savings and Loan Holding Company Amendments of 1967, Pub. L. No. 90-255, 82 Stat. 5 (1968) (codified, as amended, at 12 U.S.C. 1730a (1982)). The current provisions of the holding company regulations relating to acquisitions, 12 CFR 584.4 (1985), and the supporting definitions, *id.* at Part 583, essentially repeat the statutory provisions. The current Control Act regulations, however, implement one aspect of the control definition of that statute by establishing a presumption of control upon the acquisition of more than 10 percent of the voting stock of an insured institution when its shares are traded on an exchange or the NASDAQ System. 12 CFR 563.18–2(c)(2) (1985).

Recent developments in the financial services industry and the general area of acquisitions and takeovers have focused increased attention upon the Control Act and Holding Company Act and their implementing regulations. The shift to the stock form of ownership in the thrift industry also has made more institutions at least theoretically available for acquisition.[2] Thrift institutions additionally have become more attractive acquisition targets since their investment powers were enhanced in the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982), and under the laws of many states. This increased attractiveness comes at the time when acquisitions in general have risen numerically and the techniques used for various types of acquisitions have become increasingly sophisticated. Moreover, the perceived attractiveness of thrifts unfortunately also has led to efforts by financially weak or unstable companies and unqualified and dishonest individuals to acquire and exploit thrift institutions. As a result, substantive as well as procedural weaknesses in the regulations implementing the Holding Company and Control Acts have been too often spotlighted and misused, in some cases ultimately leaving the FSLIC to pay the price for such shortcomings.

Thus, after extensive study, the Board proposed to substantially revise its regulations in order to address these and other concerns. The Board views such a reexamination of the regulations as a necessary part of its statutory responsibility to implement the objectives of both Acts. 12 U.S.C. 1730(q)(14); 1730a(h) (1982), and particularly its duty to prevent evasions of the Holding Company Act. *Id.* at 1730a(h)(1).

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[1] The Change in Savings and Loan Control Act was enacted as Title VII of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641, 3683, which included the substantially similar Change in Bank Control Act at Title VI, *id.* at 3683 (codified at 12 U.S.C. 1817(j) (1982)). Jurisdiction under the Change in Bank Control Act is shared by the three federal banking regulators. 12 U.S.C. 1817(j)(1), 1813(q) (1982).

[2] Although the insured thrift industry remains primarily mutual (approximately 1000 stock associations vs. approximately 2000 mutuals as of September 1985), nearly 55 percent of the industry's assets are held by stock institutions. Conversions to stock form have taken place at an accelerated pace in recent years. There were 108 such conversions approved by the Board in 1983. In 1984 there were 100 conversions approved. In addition, all applications for federal *de novo* institutions have involved stock associations since formal processing rules were adopted in Board Resolution No. 83-127, 48 FR 10612 (Mar. 14, 1983).

B. Summary of the Proposal

Under the proposal, the regulatory provisions implementing the Holding Company Act and Control Act restrictions on acquisitions would have been relocated in a single new Part 574 for ease of reference and coordination and to eliminate overlapping and potentially inconsistent requirements. Regulations under the Holding Company Act relating to operations of subsidiary institutions would remain in Part 584. To the extent feasible, the implementing regulations would use common definitions of terms.

The proposal also would have established a coordinated procedure for providing public notice of filings under the Acts without sacrificing the confidentiality of their contents, thereby enhancing the opportunity for comment on a prospective acquisition and increasing the Board's sources of information in connection with its review of acquisitions and changes in control.

The new Part also would have expanded and clarified the use of rebuttable determinations of "control" to provide guidance to acquirors regarding the Board's interpretation of this term. In addition, the proposal would have introduced presumptive disqualifiers" to put applicants on notice of factors that the Board would find particularly meaningful in an application or notice and that may be deemed to disqualify a potential acquiror if not adequately rebutted.

Finally, the revisions were designed to coordinate with expansion of the authority delegated to Principal Supervisory Agents to approve and deny applications and notices and thus to expedite the processing of applications by eliminating unnecessary delays in the review process.

In proposing all of the foregoing, the Board stated its belief that by codifying past interpretations of the regulations and statutes, compliance with their requirements would be facilitated, applications processing would be expedited, and overall investment in the thrift industry would be encouraged as a result of the existence of clear and consistent ground rules. This continues to be the Board's belief, and for that reason the Board is proceeding to adopt the regulations described herein.

C. Overview of Comments

In response to the proposed amendments, the Board received 19 comment letters: ten from law firms, five from trade associations, and four from insured institutions. Most commenters generally favored the proposed amendments, citing the greater certainty that would be provided to potential acquirors and insured institutions and the clarified participatory role for target institutions. The comments varied widely. Some commenters contended that the Board had attempted to promote the entrenchment of insured institution management. Other commentors advocated the need to restrict unscrupulous acquirors, stating "the proposals do not go far enough to address control abuses in the thrift industry." There were also many useful technical changes suggested to foster a more cohesive regulatory structure. After considering the comment letters and other available information, the Board has determined to adopt the amendments substantially as proposed with certain changes discussed below.

Definitions

A. "Acquire"

Both statutes refer to acquisitions of control in their operative provisions. 12 U.S.C. 1730(q)(1); 1730a(e)(1)(B) (1982). In the majority of cases, an acquisition of control will involve the acquisition of ownership of a security of the insured institution. *See* 12 U.S.C. at 1730(q)(1), 1730a(a)(2)(A). The acquisition of securities is particularly emphasized in the Control Act, which deals with acquisitions of control through "a purchase, assignment, transfer, pledge, or other disposition of voting stock". 12 U.S.C. 1730(q)(1) (1982). In administering the statutes, the Board and its staff have scrutinized a variety of arrangements which, while not characterized as outright sales, served to vest another person with the operative attributes of ownership or control of the security. The new definition of "acquire" is the result of this experience.

The new definition of "acquire" is intended to clarify the point in time when an acquiror is deemed to have gained control of an insured institution in the context of obtaining the institution's stock. An acquiror would be deemed to acquire the stock whether it holds such stock directly or indirectly, such as through another entity which it controls. The definition also incorporates the notion that an acquiror will be deemed to have acquired stock through one or more transactions. Generally, the stock of an insured institution could be acquired through a disposition such as a purchase, assignment, transfer, exchange or succession. In addition to beneficial ownership, consistent with the statutory language of both Acts, stock will be deemed to be acquired if a person or company obtains shared or sole voting power or has control over stock by virtue of possessing sole dispositive power with regard to stock.

The Board also has determined that other situations exist in which stock would be deemed to be acquired for purposes of the Acts. For example, the regulations incorporate in the definition of "acquire" an increase in ownership of stock relative to other stockholders through a reduction in the percentage holdings of the shareholders as would occur in a selective redemption or a high ratio reverse stock split in which fractional shares are cashed out. The Board notes that the implementing regulations of other banking agencies already provide that such an increase in proportionate ownership will be deemed an acquisition of voting securities for purposes of the Control Act. *See, e.g.,* 12 CFR 225.41(a)(1) (1984) (Federal Reserve Board). The Board views this as an appropriate interpretation of the term "acquire", and, consequently, a stock transaction that causes a material realignment of ownership interests would be deemed an acquisition of control for any person or company whose holdings exceed a control threshold as a result of the transaction.

In the situation where a person's or company's holdings exceeded a control threshold as a result of a stock transaction that was essentially *pro rata* in nature, however, a filing would not be required. In addition, where a stock transaction that was not essentially *pro rata* in nature caused a person or company to exceed a control threshold and the person or company did not control the stock transaction that resulted in such increase in ownership, the person or company would have 90 days after the effective date of the stock transaction to submit the appropriate notice, application or rebuttal under § 574.3(d).

In the proposal, the Board provided that voting stock also could be "acquired" through the formation of a group by individuals and/or companies which had previously acquired stock of an insured institution individually. The concept that stock of an insured institution is acquired by a group at the time the group is formed is based in part on the determination in both the Control and Holding Company Acts that control exists when persons and/or companies act in concert. *See* 12 U.S.C. 1730(q)(1), 12 U.S.C. 1730a(a)(2)(A). Further, upon formation, the group is, in essence, acquiring the stock held by the individuals and/or companies which comprise the group. Thus, in effect, a disposition of the stock to the group has taken place. The Board notes that the

Securities and Exchange Commission ("SEC") uses a similar interpretation in the rules promulgated under Securities Exchange Act ("Exchange Act") section 13(d), 15 U.S.C. 78m(d) (1982); Exchange Act Rule 13d-5(b), 17 CFR 240.13d-5(b) (1984). Accordingly, the regulation specifies that when two or more persons and/or companies act in concert for the purpose of exercising control over the management or policies of an insured institution, the group formed shall be deemed to acquire the voting stock of such persons. Such an approach is already employed in the Board's regulations governing mutual-to-stock conversions. *See Conversions from Mutual to Stock Form*, Resolution No. 84-400, 49 FR 32340 (Aug. 14, 1984) (codified at 12 CFR 563b.3(i)(8)(iv) (1985)). The Board received no comments challenging its proposed position on the acquisition of stock through the formation of a group.

Although not specifically addressed in the proposal, the Board has recently encountered several situations which presented a question regarding the extent to which an investment advisor would be considered to have acquired the stock of its advisee for purposes of the Acts. For example, both the Control Act and the Holding Company Act deem a person or company to have acquired control of an institution whether acting alone or in concert with others. 12 U.S.C. 1730(q)(1); 12 U.S.C. 1730a(a)(2). As discussed below, the term "acting in concert" is susceptible to extremely broad interpretation. Further, the Holding Company Act defines control to include control of stock, holding with power to vote stock or holding proxies representing stock. 12 U.S.C. 1730a(a)(2). The Control Act also speaks to disposition of rights with respect to stock, which would include voting rights. 12 U.S.C. 1730(q)(1) and 1730(q)(13)(A). It has been the Board's experience that an investment advisor could well control or hold with the power to vote the stock of its advisee within the meaning of the Acts in certain situations, which exist if the advisor votes the stock alone or shares voting power with the beneficial owner or if the advisor provides advice to the beneficial owner concerning the voting of the stock. In order to address the application of the Acts to situations involving investment advisors, the Board has elected to apply the regulations in the same manner as the rules would affect all other parties possessing such control characteristics with respect to stock, but to add what is, in effect, a "safe harbor" for investment advisors. The Board has provided in the regulation that an investment advisor will not be deemed to have acquired the stock of the beneficial owner, irrespective of the general definition of the term "acquire", if the advisor votes the stock in question only upon instructions from the beneficial owner and does not provide the beneficial owner with advice concerning the voting of such stock.

B. "Acquiror"

In the proposal, the term "acquiror" was used to encompass the terms "person" and "company." The use of the term is merely intended to streamline the regulation in sections in which both an individual and a company are subject to the same provisions. The Board received no comments on the definition of "acquiror."

C. "Acting in Concert"

Both the Holding Company Act and the Control Act employ the term "acting in concert." The Control Act regulates acquisitions of control by a "person, acting directly or indirectly or through or in concert with one or more other persons." 12 U.S.C. 1730(q)(1) (1982). The Holding Company Act provides that "a person shall be deemed to have control of * * * an insured institution if the person * * * acting in concert with one or more persons" controls more than 25 percent of the institution's voting stock. 12 U.S.C. 1730a(a)(2)(A) (1982). Taken on its face, the term "acting in concert" is susceptible to a broad interpretation, potentially taking in coordinated action without an agreement among the actors or perhaps even mutual awareness. There is no explanatory discussion of the term in the legislative history of the Control Act. The congressional reports on the Holding Company Act, however, indicate the term "presupposes an agreement or understanding written or tacit, of the parties." S. Rep. No. 907, 90th Cong. 1st Sess. 7 (1967); S. Rep. No. 354, 90th Cong., 1st Sess. 10 (1967). The Board is aware that in proposing its recent revisions to the Change in Bank Control provisions found in Regulation Y, 12 CFR Part 225 (1985), for example, the Federal Reserve Board indicated that it would consider persons acting in concert if they "joined together informally through parallel action or intention for the purpose of acquiring voting securities of a bank or a bank holding company." *Bank Holding Companies and Change in Bank Control, Proposed Revision of Regulation Y*; Docket No. R-0470, 48 FR 23520, 23530 (May 25, 1983).

The proposal set forth a definition of "acting in concert" that reflects the Board's extensive experience in this area and encompasses the Board's views that the term includes (1) knowing participation in a joint activity or conscious parallel action towards a common goal whether or not pursuant to an express agreement, or (2) any combination or pooling of voting or other interests in the securities of an issuer for a common purpose, pursuant to any contract, understanding, relationship, agreement, or other arrangement, whether written or otherwise." The Board currently employs the same definition in a closely related context in § 563b.3(i) to regulate the activities of groups in acquiring the stock of recently-converted insured institutions. *See Conversion from Mutual to Stock Form*, Board Resolution No. 84-400, 49 FR 32340 (Aug. 14, 1984) (codified at 12 CFR 563b.3(i)(8)(iv) (1985)).

In order to effectuate the purposes of the Acts, the Board attempted, in the proposal, to provide a reading of the term which would include all groups of individuals and/or companies where a mutual awareness of purpose is coupled with at least a tacit agreement concerning a plan of acquisition of control. Several commentors asserted, however, that the proposed definition of "acting in concert" was too broad and would include groups of individuals who made concurrent purchases of the stock of insured institutions with no plan to control the institution. The Board did not intend that concurrent purchases alone would provide a basis for investors to come within the purview of its definition of "acting in concert." In order to clarify the Board's intent to have the term pertain only to groups where a mutual awareness exists, the Board is modifying the proposed definition to limit "acting in concert" to groups where *interdependent* parallel behavior exists in addition to situations involving knowing participation among a group towards a common goal. In the Board's view, the definition thus clarified would apply only to groups where the potential to exert a controlling influence exists.

In this regard, the Board notes that in its experience it has encountered several types of situations, involving business, familial or personal relationships where action in concert is typically present. As discussed in more detail below, the Board has provided further guidance on this point by establishing several rebuttable presumptions regarding concerted action. In addition, the Board also wishes to clarify the treatment of situations in which more than one relationship in which concerted action exists or is presumed, that relate to the same stockholder of an insured institution. In these situations, the Board has determined that unaffiliated third parties who act in concert with a person or company will be presumed to act in concert with each other. For instance, if an individual, a corporation controlled by the individual and the brother of such individual all own stock of an insured institution, the Board's regulations would require all the stock to be aggregated. Such a finding is necessary to avoid situations, as in the above example, where a company could avoid being subject to the ongoing regulation of the Holding Company Act, or where persons could evade the scope of the Control Act. Accordingly, the Board has modified the proposed revisions to provide for aggregation of parties acting in concert by specifically providing in § 574.2(c)(6) that action in concert with another person or company shall also be deemed to be action in concert with any person or company acting in concert with such other person or company.

D. "Affiliate"

The provisions of Part 574 include the definition of the term "affiliate" as it is currently used in the Insurance Regulations, 12 CFR 561.25 (1985). The term is used in the agreement which must be filed by an acquiror that attempts to rebut a determination of control in accordance with § 574.4(e). The Board received no comments on the definition of the term "affiliate", and has adopted it as proposed.

E. "Company" and "Similar Organization"

The term "company" was derived from the Holding Company Act, which defines a "company" as:

> any corporation, partnership trust, joint stock company, or *similar organization*, but does not include the Federal Savings and Loan Insurance Corporation, any Federal Home Loan Bank, or any company the majority of the shares of which is owned by the United States or any State, or by an officer of the United States or any State in his official capacity, or by an instrumentality of the United States or any State. (*Emphasis added*)

In the proposal, the Board clarified the meaning of the term "similar organization" by adding the terms "association, joint venture, pool, syndicate and unincorporated organization." These terms were added to provide certainty in accordance with the legislative history of the Holding Company Act which states that a "company:"

> [encompasses] the types of entities which, because of their capacity to bring together diverse stockholdings and exercise their voting power under single control for substantial periods, would be most likely to be able to raise the necessary capital to finance the acquisition of savings and loan associations and to engage in holding company operations.

H.R. Rep. No. 997, 90th Cong., 1st Sess. 6–7 (1967), reprinted in 1968 U.S. Code Cong. & Ad. News 1807.

No comments were received concerning the entities enumerated as "similar organizations" in accordance with the above-cited Congressional direction. However, the Board also attempted to define instances in which a group of individuals and/or companies would come together in a manner that would also constitute a "similar organization". The Board proposed the following definition:

> a group acting in concert where arrangements exist among the participants that provide for allocation of profits, losses or expenses arising in connection with their ownership of stock of an insured institution and for the disposition of their ownership interests, or which provide for either of the foregoing and also provide for the manner of voting of the stock of the insured institution held by the participants.

The Board specifically requested comment on factors that should be considered indicative of status as a company and received five comments concerning the above-cited language, most of which were critical of the definition as being too broad. Some commenters suggested that all individuals who received financing for their acquisition would be required to enter into an agreement which would cause the group to be deemed to be a company. It is not the intent of the Board that all groups of individuals acting in concert be considered companies. In order to better express its intended scope of coverage of the term "company", and in consideration of the application of other aspects of the Holding Company Act to an entity deemed to be a "company" thereunder, the Board has determined to revise its definition of a "similar organization." Further, for ease of reference, the Board has provided a separate definition of the term "similar organization" which is found in § 574.2(l).

The new definition states that the term "similar organization" means a combination of parties which has the potential for or practical likelihood of continuing rather than temporary existence and where the parties thereto have knowingly and voluntarily associated for a common purpose pursuant to identifiable and binding relationships which govern the parties with respect to either: (1) The transferability and voting of any stock or other indicia of participation in another entity, or (2) achievement of a common or shared objective, such as to manage or control another entity.

This definition is intended to better address groups which have the attributes that warrant regulation as a holding company. In general, the definition clarifies that a similar organization must have attributes comparable to those companies listed in the definition of the Act: corporation, partnership, trust and joint stock company. In order to be deemed a similar organization, a group must form through a voluntary combination. Thus the parties must be aware of and at least implicitly consent to the combination. Such a group, without more, would merely be deemed to be acting in concert. A determination that a similar organization exists additionally would require that the parties to the combination be bound together by legally enforceable means with respect to key aspects of the operation of the group. Further, only where parties may be combined for a prolonged, rather than merely temporary, duration would a similar organization be found. For example, a group that is bound together solely for the purpose of the act of acquiring control of an institution and thereafter was subject to no legally binding relationships of the type described would not be considered a "similar organization."

Finally, the Board believes that even if such a binding relationship with a continuing existence can be identified, a company would be formed for purposes of the Holding Company Act only by groups attempting to achieve certain common objectives. Clearly, voting the stock of the insured institution is an objective intended by Congress which would cause a "company" to exist. The Board believes that other common objectives concerning generally the management or control of an insured institution also would come within the definition of a "similar organization." The Board does not intend, however, to infer the existence of a company where the group of individuals shares a common objective with limited scope that does not pertain to a material aspect of the business or operations of an insured institution. The Board believes that the modified definition of "similar organization" provides clarity and adequately responds to concerns raised by commenters.

F. "Controlling Shareholder"

The regulation defines the term "controlling shareholder" for purposes of the definition of "acting in concert" and the presumptions arising pursuant thereto in § 574.4(d). A "controlling shareholder" is defined to mean a person who directly or indirectly or acting in concert with one or more other persons or entities, owns, controls, or holds with power to vote 10 percent or more of the voting stock of a company or controls in any manner the election or appointment of a majority of the company's board of directors. This definition is derived from the definition of "controlling person" already used in the Insurance Regulations, 12 CFR 561.28 (1985). For purposes of Part 574, the definition of "controlling shareholder" is used to determine certain presumptions of concerted action in § 574.4(d). The Board received no comments on the definition of the term "controlling shareholder", and has adopted it as proposed.

G. "Immediate Family"

The definition of the term "immediate family" is also taken from the Insurance Regulations and includes: a person's spouse, father, mother, children, brothers, sisters and grandchildren, the father, mother, brothers, and sisters of the person's spouse; and the spouse of the person's child, brother or sister. *See* 12 CFR 561.30 (1985). For purposes of Part 574, a person's stock in an insured institution is aggregated under the concerted action presumptions with that of members of his or her "immediate family." The Board received no comments on the definition of the term "immediate family", and has adopted it as proposed.

H. "Insured Institution"

For purposes of Holding Company regulations, "insured institution" currently is defined to include institutions whose accounts are insured by the Corporation, federal associations whose accounts are insured by the Federal Deposit Insurance Corporation, and institutions that retain insurance of accounts pursuant to § 563.28–1. This is also the general definition of "insured institution" found at 12 CFR 561.1 (1985). The current Control Act regulation expands on this definition to include savings and loan holding companies, 12 CFR 563.18–2(b)(4) (1985), implementing the last sentence of 12 U.S.C. 1730(q)(1) (1982). The Board has included all these elements in the definition of "insured institution" for purpose of Part 574. The Board received no comments on the definition of the term "insured institution".

I. "Management Official"

"Management official" as used in the proposal included any president, chief executive officer, vice president, director, partner, or trustee or any other person who performs similar policy-making functions for an insured institution or company, whether incorporated or not. The term would include such officers of subsidiaries if they perform policy-making functions for the parent and would include any person who has representatives or nominees performing such functions. The definition combines elements of Exchange Act Rule 3b-7, 17 CFR 240.3b-7 (1984), and section 210(4) of the Depository Institution Management Interlocks Act, 12 U.S.C. 3201(4) (1982). The term as proposed has been modified to respond to a commenter who was concerned that the term "executive officer" was ambiguous and may not be applied consistently. The Board has replaced the term executive officer with the specific titles of president, chief executive officer, chief operating officer, and vice president. Nevertheless, the Board notes that any person who performs functions similar to the specified executive officers will be deemed to be a "management official." The term "management official" is used for purposes of Part 574 with regard to the control factors of § 574.4(c) and the rebuttal presumptions of concerted action found in § 574.4(d).

J. "Person"

The term "person" is defined in the Holding Company Act to include an individual or a company. 12 U.S.C. 1730a(a)(1) (C) (1982). The Control Act provides a similar definition of person as "an individual or a corporation, partnership, trust, association joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity not specifically listed herein." 12 U.S.C. 1730(g)(8)(A) (1982). The Board has limited its definition of "person" to an individual or a group of individuals acting in concert that do not constitute a "company" as defined in the regulations.

The Board's purpose in restricting the definition was to further its goal of reducing the overlaps and inconsistencies between the two Acts. The practical effect of such amendment would be to subject natural persons to the Control Act and companies to the Holding Company Act. Under the Board's current regulatory scheme, a company would be subject to the Control Act procedures in order to acquire between 10 and 25 percent of the voting stock of certain insured institutions. *See* 12 CFR 563.18–2(c)(2) (1985). In that circumstance, the Board's regulations would cause the company to be deemed in control of the insured institution for purposes of the Control Act, yet not in control of the insured institution for purposes of the Holding Company Act.

As is discussed in detail below, both Acts provide substantially the same definition of "control." The revised definition of "person" therefore serves to eliminate the inconsistent application of substantially similar terms. Further, after a company had received clearance to acquire "control" of an insured institution under the Control Act, the company would be required to receive Board approval to again acquire "control" under the Holding Company Act prior to acquiring an aggregate of more than 25 percent of the voting stock of the insured institution. The revised definition of "person" in conjunction with the amendment proposed to the definition of control allows the Board to administer consistent concepts of control and saves the time and expense of potential acquirors, insured institutions and the Board's staff. The Board received no comments on the definition of the term "person".

K. "Savings and Loan Holding Company"

The definitional provisions of Part 574 include the same definition of "savings and loan holding company" now found in 12 CFR 583.11 (1985). In the proposal the Board amplified the terminology used in the statute to clarify that an exception for certain types of trusts that control an insured institution is available only to such trusts which controlled the insured institution on June 26, 1967. Such amendment is consistent with the congressional intent of the meaning of the exception, in the opinion of the Board's Office of General Counsel. *See* Ops. G.C. May 1, 1985, June 25, 1984. No comments were received on the definition of the term "savings and loan holding company", and the provision has been adopted as proposed.

L. "Stock" and "Voting Stock"

Voting stock plays a critical role in both Acts because acquisition or ownership of voting stock is the primary determinant of control. Both statutes include conclusive determinations that control exists upon the ownership or acquisition of more than 25 percent of an insured institution's voting shares or securities (or rights with respect thereto).[4] *See* 12 U.S.C. 1730(q)(8)(B)

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[4] Although the Control Act restricts acquisitions of control through acquisitions of "voting stock", 12 U.S.C. 1730(q)(1) (1982), the control presumption in that statute references "voting securities." *Id.* at 1730(q)(8). The Holding Company Act refers to "voting shares". *Id.* at 1730a(a)(3).

1730a(2)(A) (1982). The term "voting stock", however, is not defined in either statute. While the Control Act offers a definition of "stock" as "such stock or other equity securities or equity interests in an insured institution which is a stock company, or rights, interests, or powers with respect thereto", 12 U.S.C. 1730(q) (13) (1982), the Holding Company Act is silent.

In the proposal, the Board incorporated the Control Act definition of "stock" into its regulations and further adopted a definition of the term "voting stock" similar to that of the Federal Reserve Board at 12 CFR 255.2(e)(1) (1984). In the Board's view, stock, partnership shares or similar interests are "voting stock" if they entitle the holder to vote for directors or persons with the equivalent managerial functions, or if in any other manner voting of the securities allows the holder to direct the operations or any significant policies of the issuer. The definition excludes, however, preferred stock if its voting rights are limited to those necessary to protect the investment and do not otherwise provide control. In this regard, the Board notes that preferred stock that would have voting rights upon the occurrence of specified events, *e.g.*, a default in payment of dividends, would not be deemed to be "voting stock" until the triggering event occurred, unless, of course, other characteristics of the stock would cause it to come within the "voting stock" definition. Finally, "voting stock" was used in place of "voting shares" to avoid confusion with share interests in a mutual institution.

The scope of the term "voting stock" is clarified with respect to options and rights to acquire stock and securities convertible into stock. It is noted that the phrase in the Control Act definition of stock by which "rights, interests, or powers with respect to" stock are deemed to be stock is broad enough to encompass virtually all options, warrants and convertible securities. In the Board's view, however, the definition should be tailored so as to include only those instruments in which the holder is subject to the preponderant economic risk with respect to the underlying voting stock. Thus, the definition of "voting stock" in the proposal and as adopted by the Board today includes securities that are convertible into "voting stock" or exercisable to acquire "voting stock" at the direction or option of the holder, where the preponderant economic risk of ownership of the underlying stock has shifted to the holder of the convertible security or right to acquire "voting stock."

In the case of securities immediately convertible into "voting stock" at the option of the holder, without payment of additional consideration, the Board regards the holder as possessing the preponderant economic risk with respect to the underlying "voting stock" and therefore such securities will be treated as the equivalent of the "voting stock" into which they are convertible. In this regard, a security would be treated as immediately convertible if its conversion were subject only to regulatory approval by the Board which would be required in any event. *See* FRB Staff Op. (May 14, 1984), 1 Fed. Res. Reg. Serv. section 4-397.2. In the case of other securities convertible into "voting stock" in different circumstances and of instruments representing rights to acquire "voting stock" such as options or warrants, the question of whether the holder possesses the preponderant economic risk in the underlying stock must be resolved on the basis of the particular facts of each case.

For example, a party may enter into an option agreement in which a substantial portion of the purchase price is paid prior to conversion or exercise. Arrangements also may provide an additional economic interest in the stock such as a provision that if the option goes unexercised, the optionee has the right to share in profits (or loss) upon sale of the security. Although record ownership has not passed, the arrangement gives the optionholder an economic interest in the stock equivalent to ownership and raises serious questions regarding actual control of the optioned stock. For such reasons, for example, an arrangement having such attributes was deemed the sale of a security to the optionee for purposes of section 16(b) of the Exchange Act, 15 U.S.C. 78p(b) (1982). *See Bershad* v. *McDonough*, 428 F. 2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971). The regulations adopted today provide, however, that the Board generally would consider the holder of a security convertible into "voting stock" or of rights to acquire "voting stock" *not* to possess the preponderant economic risk of ownership of the underlying stock where the holder has paid less than 50 percent of the consideration required to directly acquire the stock and has no other economic interest in the underlying stock. In other situations where the holder's economic stake in the underlying voting stock exceeds this level, or is less than 50 percent but is coupled with another interest in the underlying stock, the Board expects that specific questions as to whether a security constitutes "voting stock" will be resolved by consulting the Board's Office of General Counsel.

The Board believes that the foregoing treatment of convertible securities and rights to acquire "voting stock" reflects a realistic assessment of the actual control that may be exercised by parties owning or holding such securities or rights. In particular, the Board believes that the definition of "voting stock" is appropriate in view of the various non-traditional means for achieving control that have developed in the modern financial markets, in order to enable the Board to carry out its responsibilities to scrutinize acquisitions and changes of control of insured institutions *before* effective control has changed hands. The Board notes further that the definition of "voting stock" should not include a cutomary stock purchase agreement, and thus *bona fide* negotiated transactions should not be hampered by the application of the rule.

Finally, the definition of "voting stock" also includes securities that, upon transfer or any other event within the control of the holder, would become "voting stock", unless the securities also require that they can only be transferred in a widely dispersed sale or public offering. This provision of the definition is necessary to address arrangements in which an institution issues to a prospective acquiror a security which converts to "voting stock" upon transfer to a third party. Such securities have been used in stakeout agreements to give the prospective acquiror assurance that the target will not become the subject of another takeover. Since these arrangements give the prospective acquiror substantial control over a large block of stock, including the ability to transfer control to a third party, the Board is of the view that such a security is tantamount to acquisition of the stock itself. The Board notes that the Federal Reserve Board has taken a similar position with respect to such arrangements under the Bank Holding Company Act. *See Policy Statement on Nonvoting Equity Investments by Bank Holding Companies*, 12 CFR 225.143(c)(6) (1984).

With respect to the treatment of warrants and options, one commenter argued that all warrants and options to acquire "voting stock," except those for which no consideration at all has been paid, should be deemed to be "voting stock." The Board agrees that, where no consideration has been paid, convertible securities generally should not be deemed to be "voting stock." However, in the experience of the Board, when an acquiror has paid less than 50 percent of the conversion price. the preponderant economic risk may not have been assumed and the interest in the underlying voting stock cannot be presumed to be equivalent to ownership. In this case the holder is not in a position of assuming the real economic risk of ownership as had it paid in excess of 50 percent of the exercise or conversion price. Further, because the holder must commit substantial financial resources in order to obtain the "voting stock," the Board believes that an institution's management may be less likely to be influenced by demands of the holder than if the underlying "voting stock" could be obtained without further substantial cost. Therefore, the Board has determined not to change the text of the provision in the final regulation as suggested by the commenter.

Another commenter requested that the phrase "no other economic interest" in the underlying voting stock be clarified in the context of providing the holder of securities with the preponderant economic risk. As noted above, it has been the Board's experience that an option holder may have an additional interest in the underlying "voting stock," such as the ability to share in any profit derived from the sale of the underlying "voting stock," or to direct the sale of the stock. In such a case, the Board could deem the option holder to own the "voting stock" based on his interest in the value of such stock. The existence of other economic interests will depend upon the facts and circumstances of each particular case, however, and therefore, the Board has concluded that it would not be feasible to further refine this aspect of the definition.

The Board also received an inquiry from one commenter concerning the proper calculation applied to convertible securities or rights to acquire "voting stock" which are deemed to be "voting stock" for purposes of determining whether control of an insured institution exists. In response, the Board has clarified the manner in which the calculation should be made. The final regulation details that for the purposes of calculating the percentage of voting stock held by a particular acquiror, stock or other securities convertible into "voting stock" or exercisable to acquire "voting stock" which are deemed "voting stock" are included in calculating *both* the amount of voting stock held by the particular acquiror and the total amount of stock outstanding, only to the extent of the voting stock obtainable by the *acquiror* by conversion or exercise of such stock or other securities.

Acquisitions of Control

A. Summary

Section 574.3 sets forth the prior-review requirements for an acquisition of control of an insured institution. The section is divided into two paragraphs which differentiate between acquisitions which are subject to either the Control Act or the Holding Company Act, a paragraph which describes transactions that are exempt from review, a paragraph describing transactions that are exempt from prior Board scrutiny but are subject to post-acquisition review, and a paragraph that describes transactions which are absolutely prohibited under the Holding Company Act.

B. Required Application or Notice

Paragraph (a) restates the acquisition restriction requiring prior Board approval of an application filed pursuant to the Holding Company Act which is now found in 12 CFR 584.4 (a) and (b). Pursuant to the Holding Company Act, any company, including a savings and loan holding company, is prohibited from acquiring control of an insured institution unless it has received the prior written approval of the Board. As is discussed below, a potential acquiror must follow the procedural requirements regarding holding company applications found in § 574.6. An application may be approved under this paragraph by the Principal Supervisory at the appropriate Federal Home Loan Bank if the application complies with the Board's standards for delegated authority found in § 574.8.

Paragraph (b) requires the submission of written notice by any person (or group of persons) seeking to acquire control of an insured institution. Such notice must include information required by the Control Act in the appropriate form provided by the Board. This paragraph replaces the prior-notice requirements of the Control Act regulation now found at 12 CFR 563.18-2(c). A determination of whether to disapprove a notice must be rendered within the 60 day review period as described in § 574.6 and may also be made by the Principal Supervisory Agent if the application or notice complies with the standards for delegated authority, found in § 574.8.

C. Transaction Exempt From Review

In paragraph (c) of § 574.3, the Board has described acquisition-of-control transactions which are entirely exempt from the Board's review process. The paragraph is divided into three components and incorporates exemptions that are provided by the Holding Company Act and in the Board's current regulations implementing the Control Act, with a third exemption for transactions in which information has been submitted to the Board or which have been approved under the current regulations.

Subparagraph § 574.3(c)(1) provides five exemptions for transactions involving acquisitions of insured institutions by "companies" which would otherwise be subject to the application and prior-approval process. The same exemptions are made available, where applicable, to acquisitions by "persons" pursuant to § 574.3(c)(2)(i). The first, enumerated as § 574.3(c)(1)(i), exempts transactions in which control is acquired under the terms of testamentary trusts exempt from the definition of savings and loan holding company. *See* 12 U.S.C. 1730a(a)(3)(B). This exemption merely obviates the need for such a trust to receive prior approval to control an insured institution because Congress has determined that such a trust need not be regulated as a savings and loan holding company. It is noted that an exemption is not provided for *inter vivos* trusts because the exemption in the Holding Company Act only extends to such trusts which already control an insured institution. *See* 12 U.S.C. 1730a(a)(3)(i) (1982); 12 CFR 574.2(k)(2)(i).

The second exemption concerns reorganizations which are exempted from the application process in the Holding Company Act at 12 U.S.C. 1730a(e)(1)(B)(ii). The exemption allows the acquisition of control of an insured institution by a newly formed company which is controlled by the same acquirors (which may be persons or companies) that have controlled the insured institution for the immediately preceding three years. The Board is aware that simple reorganizations which would not vest control of the institution in any new stockholders may fail to qualify for the exemption due to the widely-held nature of the institution's stock, and that such reorganizations ordinarily do not present major substantive issues for review. Accordingly, the Board already has directed its staff to devise a streamlined review procedure for these types of transactions, which the Board hopes to be able to consider in the near future. This second exemption also codifies the Board's long-standing interpretation that only simple reorganizations are exempt and if any other transaction occurs, such as an assumption of a previous owner's debt by the new holding company, the reorganization does not qualify for exempt status. In order to take advantage of this exemption, acquirors are required to file a Form H-(e)4 demonstrating their qualification. The Board's General Counsel is delegated authority to consider the filing and is obliged to indicate any disapproval of the claim of qualification for the reorganization exemption within 30 days of receipt, or the reorganization would be deemed to be approved. Because of the specificity of this exemption, the Board finds that its policy statement on exempt reorganizations, at 12 CFR 589.2 is no longer necessary and is revoking it.

It should be noted that pursuant to the language of the Holding Company Act and past interpretations of this provision, the Board would regard this reorganization exemption as applicable only where the controlling person or persons have remained unchanged for the entire three-year period and group members have acted together to exercise control of the institution. *See*, e.g., Op. G.C. March 12, 1970. Further, the defined term "acquiror" is employed to clarify that companies may make use of the exemption. The Holding Company Act provides that the exemption is available for "persons" that have had the requisite control. The definition of "acquiror" in the final regulations is substantially identical the definition of "persons" in the Holding Company Act. *See* 12 U.S.C. 1730a(a)(1)(G). Thus, in the Board's view, the new regulation simply clarifies the types of transactions covered by the Holding Company Act.

The third exemption concerns the acquisition of control through the pledge or hypothecation of stock or the liquidation of a loan, in both cases where the transaction was contracted in good faith and in the ordinary course of business of the lender. The exemption extends for one year from the date that control was acquired, but may be extended further upon written approval of the Board. This exemption is derived from the exemption provided for in the Holding Company Act at 12 U.S.C. 1730a(e)(4). The Board notes that where a company qualifies for this exemption, such a company would, in fact, be a savings and loan holding company and as such subject, *inter alia*, to the registration requirement of the Holding Company Act at 12 U.S.C. 1730a(b), but would not be required to secure the Board's approval prior to exercising control (including taking possession) of the stock. The Board further notes that this exemption is intended to be limited to instances in which the secured lender needs to act quickly in order to protect its investment. It is also the Board's view that this exemption is unlikely to be available to "persons" rather than "companies" because of the requirement that the loan in question be in the ordinary course of business of the lender. In light of previous experience, the Board has concerns that fraudulent transactions may occur in which a person becomes a debtor with the intent of defaulting so that the lender may acquire control of an insured institution while avoiding prior approval under the Acts. Accordingly, the regulation requires that the Board be notified within 30 days of any transaction for which this exemption is claimed in order to monitor compliance and to ensure that the exemption is available only for loans contracted in good faith and in the ordinary course of business of the lender. In addition, it should be noted that this does not relieve an insured institution or insured bank from its obligation to report a loan secured by stock of an insured institution under § 574.5(b), discussed below.

The Board has clarified two other situations in which exemptions exist which are not expressly provided for in either the Holding Company Act or the Control Act. The first concerns control obtained through a percentage increase in stock ownership following a *pro rata* stock dividend or stock split, in cases where the proportional interests of the recipients remain substantially the same. As previously discussed, the stockholder would not be deemed to "acquire" the stock and therefore would not be subject to the prior-approval requirements. *See* 12 CFR 574.2(a).

The final rule also provides an exemption to clarify the fact that once control of an insured institution is approved, additional stock may be acquired without Board approval, if the acquisition is consistent with representations made by the acquiror in its application or notice and with any conditions imposed by the Board or its delegate in the initial approval. The Board wishes to take this opportunity to put prospective acquirors on notice that their applications or notices will be reviewed and their financial resources analyzed as if they were seeking to acquire 100 percent of an insured institution's voting stock, unless their application or notice specifically states otherwise. In the latter case, the application or notice will be analyzed with respect to such amount, but the Board or its delegate may limit its approval to the acquisition of such amount. Where the Board conditions its approval to acquire control on the purchase of a limited amount of stock, an applicant seeking to make additional acquisitions would be required to apply to have that condition modified based on a change of circumstances.

Section 574.3(c)(2) provides four exceptions for transactions which would otherwise require prior notification of the Board pursuant to the Control Act in accordance with § 574.3(b). First, the Control Act is specifically inapplicable to any transaction which is subject to the Holding Company Act. 12 U.S.C. 1730(q)(17). Accordingly, any transaction for which approval is required under paragraph (a) of § 574.3 (implementing the Holding Company Act acquisition application process) is exempted from the notice requirement of paragraph (b) of § 574.3. Second, any type of transaction which is excepted from review under the Holding Company Act is excepted from the Control Act notice requirement by § 574.3(c)(2)(ii). The third exception covers transactions for which other applications are filed where the Board will receive information comparable to what it would receive in a Control Act notice. This exception is limited, however, to exclude situations where the acquisition of control through the other transaction, e.g., merger, would cause individuals who were not previously in control of an FSLIC-insured institution in accordance with the Control Act, to acquire control. For example, the exception would not apply if, as part of a merger transaction, an individual not currently in control of an insured institution would acquire control. In that case, a Control Act notice would need to be filed in addition to the merger application.

The exemptions also include the current regulatory exemption for acquisitions of additional stock of an insured institution either by a person (including persons acting in concert) who (1) has continuously held more than 25 percent of an institution's voting stock since the effective date of the Control Act, March 9, 1979, or (2) has maintained control of the insured institution continuously since acquiring control in compliance with the Control Act and regulations thereunder, provided the acquisition is consistent with any conditions imposed in connection with the previous approval and with any representations made by the acquiror in its notice. With respect to both exemptions, the Board wishes to note that where the 25 percent ownership or control exists by virtue of a group of persons acting in concert, the exemption is available only for the group as constituted on March 9, 1979, or at the time of acquisition of control in compliance with the Control Act as the case may be. In addition, an exemption is provided with respect to persons that would have been deemed to control an insured institution on the basis of the proposed control presumptions prior to the effective date of this regulation. Proposed § 574.3(c)(2)(iv)(C) has been eliminated because its provisions are incorporated in other sections of the regulation.

With respect to all of the foregoing exemptions, acquirors also should be aware that the presence of an exemption for the approval process or an exemption from the requirement of prior approval under the Holding Company Act does not necessarily mean that the acquiror is exempt from other provisions of the Holding Company Act. As previously discussed, certain trusts are specifically excluded from the definition of a savings and loan holding company and thus would be entirely exempt under the Act. However, a company that acquires control of an insured institution in connection with a foreclosure that is exempt from the approval process, for example, is exempted only from sections 408(c)(2) and 408(g) of the Holding Company Act, 12 U.S.C. 1730 (c)(2) and (g) (1982). Other types of exempt acquisitions of control, such as an exempt reorganization, also leave the acquiring company fully subject to all other provisions of the Holding Company Act.

The Board is aware that acquisitions are in progress during the course of this rulemaking procedure, and that applications or notices have been filed with the Board without a determination being rendered by the Board upon this regulation becoming effective. The Board has, therefore, determined that all applications and notices which were filed and are materially complete on the effective date of this regulation will be subject to the current regulations under the Control Act and the Holding Company Act.

The Board received several comments concerning the extent to which the rule would apply to acquirors whose status as of the effective date of the rule is within the scope of a control determination yet who were not deemed to be in control of an insured institution under the Board's current rules. One commenter urged the Board to require all companies that would be deemed to control an insured institution based on the new regulations be given a brief grace period either to file for approval of their control relationship or divest their holdings. The Board does not believe that such a result would be equitable or feasible. Such a result could require an acquiror to file for regulatory approval based upon actions taken—potentially years ago. Further, as previously discussed, both the Control Act and the Holding Company Act generally envision filings *prior* to an acquisition of control of an insured institution. However, the Board will require a notice, application or rebuttal agreement, as appropriate, to be filed and approved prior to such an acquiror acquiring *any additional voting stock or obtaining any additional control factor* after the effective date of the rule.

D. Transactions Exempt From Prior Approval or Notice

Section 574.3(d) specifies exemptions from the requirements of prior approval or prior notice under the Holding Company and Control Acts, respectively. These limited exemptions are provided to accommodate situations where persons or companies may not be capable of controlling the timing of the transaction which results in the control relationship. Similar exemptions, for stock acquired through a *bona fide* gift, testate or intestate succession, or in satisfaction of a debt contracted in good faith, currently appear as exemptions from prior notice under the Control Act regulations at 12 CFR 563.18-2(d)(2) (i) and (ii) (1985). Control that is obtained through a percentage increase in ownership following a stock split or redemption that was not *pro rata* or essentially *pro rata* in nature also may be exempt from a prior-filing requirement and also are subject to an after-the-fact filing, as are all the transactions in this category. Transactions included in this exemption also may arise where a person or company acquires voting rights with respect to previously non-voting stock, *e.g.*, upon default or payment of dividends on preferred stock, or gains a control factor, *e.g.*, becomes one of the two largest shareholders of an institution, such as if the largest shareholder sells its stock to several purchasers, as a result of actions of third parties not within the acquiror's control. In the event an investor thereby would be determined to be in control, either conclusively, or subject to rebuttal, the prior-filing exemption would be available.

These exemptions, however, are subject to certain conditions in order to safeguard against abuses. First, an acquiror obtaining stock or a control factor under circumstances covered by an exemption from prior approval or prior notice must file an application, notice or rebuttal with the Corporation as soon as practicable and at least within 90 days of acquisition of the stock or control factor. A rebuttal, application or notice submitted under these circumstances would *not* be treated as an after-the-fact rebuttal, application or notice, as the case may be, submitted by a party in control of an insured institution in violation of the Board's rules, which would constitute a "presumptive disqualifier" under the rule. Second, during the pendency of the Corporation's review, the acquiror may not take any actions designed to influence the management or policies or effect a change in control of the insured institution in question, and the Corporation may require the acquiror to take steps such as putting excess stock in trust or agreeing to *pro rata* voting arrangements to ensure that control is not exercised. Third, if the Board disapproves the acquiror's application or notice, the acquiror will be required to divest stock or otherwise assume a noncontrol status within one year of the Board's action, or such shorter period as the Board may order in rendering its decision. It is noted that control acquired through testate or intestate succession is subject to less cumbersome procedures. The Board believes that these procedures are adequate to monitor changes in ownership that may occur through testate or intestate succession.

The Board notes that these exemptions are predicated upon the assumption that acquirors may gain control of an insured institution through a transaction over which they have no control. The regulations require that an appropriate application, notice or rebuttal would be filed prior to the acquisition if the acquiror were capable of controlling the timing of the stock transaction, or other event that caused the acquiror to be deemed to be in control.

E. Prohibited Acquisitions

Paragraph (e) sets forth the Holding Company Act's prohibitions on acquisitions that would result in the formation of certain interstate holding companies. See 12 U.S.C. 1730a(e)(3) (1982). Such acquisitions may be approved, however, in accordance with the emergency thrift-acquisition provisions of 12 U.S.C. 1730a(m) (1982). In addition, the Board may arrange interstate supervisory mergers involving federally-chartered subsidiaries of holding companies pursuant to its branching policy statement for federal associations. 12 CFR 556.5(a)(3) (1985). See *Independent Bankers Association of America v. Federal Home Loan Bank Board*, 557 F. Supp. 23 (D.D.C. 1982). In addition, paragraph (e)(1) also has been amended to codify recent interpretations of the scope of the "multi-state multiple" provisions of the Holding Company Act issued by the Office of General Counsel.

Determinations of Control

A. Summary

The most extensive amendments to the current regulations contained in the proposal concerned the clarification of the definition of "control" of an insured institution. As already noted, both the Control Act and the Holding Company Act employ broad definitions of the term "control". The Control Act describes control as the power, directly or indirectly, to direct the management or policies of an insured institution. 12 U.S.C. 1730(q)(8)(B) (1982). The Holding Company Act provides that the term includes control in any manner of the election of the majority of the directors of an insured institution. *Id.* at 1730a(a)(2)(A). Control also may be found under the Holding Company Act if the Corporation determines that a person, directly or indirectly, exercises a controlling influence over the management or policies of an insured institution. *Id.* at 1730a(2)(D). Under either statute, the acquisition of more than 25 percent of an insured institution's voting stock is conclusively deemed the acquisition of control. 12 U.S.C. 1730(q)(8)(B); 1730a(a)(2)(A) (1982). While the current Holding Company Act regulations simply restate the statutory indicia of control, 12 CFR 583.26 (1985), the Control Act regulations, like those of the other federal financial institutions regulatory agencies, set forth an additional presumption of control at 12 CFR 563.18-2(c)(2) (1985). This presumption arises when a person acquires the power to vote more than 10 percent of any class of voting securities of an insured institution that has a class voting securities registered under section 12 of the Exchange Act, 15 U.S.C. 78l (1982), and such stock is "actively traded."[8]

With the increase in acquisition activity in recent years, the Board and its staff have regularly been confronted with a variety of investments in securities of insured institutions which raise control concerns under the statutes but which may not be precisely covered by the control criteria set forth in the current regulations. To deal with these situations, the Board has resorted to the generalized formulations of control in the statutes to compel compliance. The variety of the Board's experience in administering the Control Act and Holding Company Act has allowed it to identify certain factors that raise questions as to whether the investor has the power to control the association or is in fact exerting a controlling influence on the institution. To facilitate compliance with the Acts, and to expedite resolution of these issues, the regulations incorporate these factors as part of a more comprehensive and realistic series of control determinations. When such factors are present at the same time an investor has a certain level of securities ownership, the investor would be determined, subject to rebuttal, to have acquired control. This revised system should not only serve the Board's goal of increased compliance but should also benefit acquirors and investors by giving them advance notice of how the Board will examine their investments.

Control determinations under both Acts are set forth in § 574.4. The section is divided into control determinations specifically mandated by the Acts and control determinations based upon circumstances which, in the Board's experience, constitute situations in which an acquiror typically would be capable of actual control by directing the management and policies of an insured institution. The control determinations which are mandated by the Acts are termed "conclusive control determinations" and are set forth in § 574.4(a). The control determinations which would otherwise provide an investor with actual control are enumerated in § 574.4(b) and termed "rebuttable control determinations."

Both conclusive and rebuttable determinations of control may occur on the basis of one or more transactions. Thus, the proper filing must be made prior to the commencement of a multistep transaction which would ultimately vest the acquiror with control of an insured institution.

B. Conclusive Control Determinations

Section 574.4(a) sets forth as conclusive control determinations the statutorily specified criteria of the term "control." Paragraph (a) follows the statutory criteria and establishes a conclusive determination of control when an acquiror, directly or indirectly, or acting in concert with others, acquires more than 25 percent of a class of voting stock of an insured institution. The provision integrates the control determinations of the two statutes. Although the Holding Company Act speaks of a person who "owns, controls or holds with power to vote, or holds proxies representing" stock while the Control Act refers to a person who "acquires" the stock, the two statutory provisions have been interpreted in a manner that covers essentially the same transactions. As a rule, an acquisition of stock results in control of that stock. The implementing regulations also specify that control is achieved upon the acquisition of more than 25 percent of a *class* of voting stock, which is the language used in the Control Act. The Holding Company Act provides that control is present upon ownership or control of more than 25 percent of an institution's voting "shares" rather than a class of voting stock. In most cases the change will not make a difference because insured institutions generally only have one class of voting securities. The Board has noted, however, that there are institutions that have begun using different classes of common stock to limit or structure control of the institution, a situation not present when the Holding Company Act was drafted. In the Board's view, the acquisition of 25 percent of such a class would raise Holding Company Act concerns and should be subject to its requirements in order to prevent evasions of the Act.

Paragraph (a) also lists other conclusive control determinations, including, with respect to both an insured institution and a company, holding irrevocable proxies representing more then 25 percent of any class of voting stock of the institution or company; any combination of shares of a class of voting stock and irrevocable proxies with respect to such stock representing more than 25 percent of the class; control in any manner of the election of a majority of the institution's or company's directors; and, with respect to determining control of a company only, control of the election of a majority of the company's trustees, a position as general partner, contribution of more than 25 percent of capital, or a position as trustee with respect to control of a trust.

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[8] As originally promulgated, the Board's Control Act regulations established two control presumptions deeming a person to acquire control if he or she acquired more than 10 percent of an insured institution's stock and either (1) The institution had a class of stock registered under the Exchange Act, or (2) the acquiror was the institution's largest shareholder following the acquisition. *Amendments Relating to Change in Savings and Loan Control Act*, Board Resolution No. 79-121, 44 FR 10800 (Feb. 21, 1979). These presumptions were the same ones that are currently found in the regulations of the other federal financial institutions regulatory agencies. *See* 12 CFR 5.50(e); 225.41(b)(2); 303.15(a) (1984). Subsequently, the control presumption with respect to institutions with a registered class of voting securities was limited to institutions that had more than 1200 shareholders and $250 million in assets. *See Federal Savings and Loan Institutions; Change in Control*, Board Resolution No. 80-481, 45 FR 56060 (Aug. 21, 1980). Finally, in 1982, the presumption regarding largest shareholders was eliminated and the presumption with respect to institutions with a registered class of voting securities was revised to require active trading in the stock, rather than 1200 shareholders and $250 million in assets. *Amendments Relating to Change in Control*, Board Resolution No. 82-487, 47 FR 34120 (Aug. 6, 1982).

Finally, paragraph (a) states general definitions of actual control for both statutes. Although the wording of the Control Act control definition, 12 U.S.C. 1730(q)(8)(B) (1982), differs slightly from that contained in the Holding Company Act at 12 U.S.C. 1730a(2)(D) (1982), the Board believes that the differences in formulation are not of substance and that both statutes were designed to address the same general type of controlling influence over the affairs of an insured institution. In the Board's view, it is appropriate that control determinations under both the Control Act and the Holding Company Act be made in advance of actual exercise of controlling influence. Prior review is fundamental to the purposes and structure of both Acts. Advance determinations are necessary in order to avoid consummation of transactions that would frustrate the purpose of the Acts and to save acquirors from substantial expenditures that ultimately may be deemed unlawful under the Holding Company Act's "controlling influence" standard. The Board notes that the Federal Reserve Board has adopted a similar position under the Bank Holding Company Act in its revisions of Regulation Y. *See* 12 CFR 225.2(d)(1)(iii) (1984).

Bank Holding Companies and Change in Bank Control; Revision of Regulation Y, Docket No. R-0470, 49 FR 794, 799 (Jan. 5, 1984).

C. Rebuttable Control Determinations

In addition to setting forth the criteria for actual control as stated in the Acts, the Board has supplied rebuttable control determinations which describe specific circumstances that, in the Board's experience, typically enable an investor to direct the management or policies of an insured institution. The rebuttable determinations of control reflect the experience of the Board and its staff in reviewing investments in insured institutions and are intended to put acquirors on notice of the Board's position regarding control under both statutes and to expedite the process of resolving questions of control.

The Board wishes to point out that these rebuttable control determinations do not operate as presumptions, as under the current Control Act regulations. Rather, they present determinations of control which are subject to rebuttal pursuant to specified requirements and procedures. If such procedures are not followed (or specifically waived by the Board), the control determination is not rebutted and the acquiror in question would be deemed to be in control.

In the context of the Holding Company Act, the rebuttable determinations of control are based on the "controlling influence" criterion which requires that the Board provide reasonable notice and an opportunity for a hearing on such a determination, 12 U.S.C. 1730a(a)(2)(D) (1982), and have been derived from the Board's experience with situations where a company may exert actual control over an insured institution, as well as an examination of control concepts applied in the context of other statutes. The rule provides that a prospective acquiring company whose planned acquisition would come within the scope of one or more of the rebuttable determinations of control must either seek to rebut the determination of control or file the appropriate application before proceeding with the acquisition. If the company proceeded with a rebuttal, it would make a rebuttal submission in the manner described in the rule. In order to avoid delays in considering rebuttals, authority to consider rebuttals continues to be delegated jointly to the Board's Office of Examinations and Supervision and Office of General Counsel and will be considered under criteria, procedures and deadlines that are also part of the rule and are discussed below. If the rebuttal submission did not meet the rebuttal criteria, the acquiror would be notified that its rebuttal was not accepted. If the acquiror were a company and the company were then to proceed with the acquisition, rather than file the appropriate application, the facts presented in the acquiror's rebuttal effort could be the basis upon which a notice, with opportunity for hearing, could issue. The Board wishes to emphasize that where acquirors subject to the Holding Company Act chose to proceed with an acquisition without filing and receiving approval of an application, the Board has the firm intention to pursue such actions through additional administrative procedures.

The Control Act does not present the procedural complexity in the use of rebuttable determinations that is presented by the "controlling influence" standard of the Holding Company Act. The Control Act defines "control" as the power, directly or indirectly, to direct the management or policies of an insured institution *or* to vote 25 percent or more of any class of voting securities of the insured institution. 12 U.S.C. 1730(q)(8)(B) (1982). The rebuttable determinations of control as applied in the Control Act context again are based upon the Board's experience in observing actual contol situations, as well as other statutory control standards, and implement the first part of the foregoing definition. Application of the rebuttable determinations as a basis for a finding of control under the Control Act does *not* require a prior hearing before a violation of the acquisition restrictions may be found. The rebuttal process would be available under the Control Act, and again the rule provides that a prospective acquiring persons whose acquisition would be within the scope of one of the rebuttable determinations of control would either seek to rebut the determination or file the requisite notice and obtain clearance before proceeding with the acquisition.

In its proposal, the Board had set forth a rather complex scheme of rebuttable control determinations based on four components: (1) Whether the target institution's stock was actively traded, (2) whether the stock to be acquired was voting stock, (3) the amount of stock to be acquired, and (4) certain "control factors" which were divided into primary and secondary categories. The Board received numerous comments concerning the extent of the rebuttable determinations. Upon review of these comments, the Board has determined that the rule would be more effective if this system of rebuttable control determinations were simplified. Accordingly, in the final regulation, the Board has reduced the potential combinations of factors through which control may be determined and retained only the most meaningful components from the proposal.

The Board has eliminated the proposed distinction based on whether the stock to be acquired is "actively traded." While the widespread ownership of actively-traded stock might more readily facilitate the realization of control of an insured institution than an institution whose stock ownership is more concentrated, the Board has concluded that the stock ownership thresholds are at a level that should furnish a stockholder of any institution, when coupled with control factors, with the power to direct management or policies of the institution. Further, because these control determinations are rebuttable, the distribution of the institution's stock will remain an element in the determination of control which may be raised in the rebuttal process.

In the final regulation, rebuttable control determinations arising from stock ownership are divided into only two categories which involve voting stock and non-voting stock. With regard to the ownership of voting stock, the final regulation in § 574.4(b)(1)(i) states that an acquiror will be deemed to control an insured institution, upon acquiring more than 10 percent of any class of *voting* stock of an insured institution, if the acquiror is also subject to any control factor. This determination may well be less sweeping than the presumption contained in the current Control Act regulation, which presumes control based upon the acquisition of more than 10 percent of an actively traded institution's voting stock, irrespective of the existence of control factors. Notwithstanding this fact, the Board received a comment that the rebuttable determination of control based on the ownership of 10 percent or more of voting stock is an unauthorized expansion of the concept of control and inconsistent with the intent of the Control Act. In light of the purpose and language of both Acts, the current Control Act regulation, and the regulations of other federal financial regulatory agencies under the Change of Bank Control Act, the Board believes that this comment is not well founded. As discussed at length herein and in the preamble to the proposal, the rebuttable determination based in part on 10 percent ownership represents a situation in which a stockholder generally is capable of directing the management or policies of an institution. Congress directed the Board to make such determination by including such a subjective standard in both the Control Act and the Holding Company Act.

Nevertheless, the Board has carefully considered the concern expressed by the commenter. In so doing, the Board has reviewed not only its experience with its current rule, but also a variety of other settings in which other agencies administer statutes in which control concepts are applied. For example, the Board, historically, has equated the "power to direct" with power to vote 10 percent of a class of stock. Prior to the enactment of the Control Act, the Board required after-the-fact reporting of changes in control. Control was defined as "the power to directly or indirectly direct * * * and includes but is not limited to any change in the direct or indirect ownership of more than 10% of the voting stock of an insured institution." 32 FR 11044 (July 28, 1967). In addition, since 1976, the Board has required prior approval and reporting of acquisitions of more than 10% of the voting shares of institutions that have recently converted from mutual to stock ownership. 41 FR 50414–15 (Nov. 16, 1976). On this basis, the Board believes that the levels of stockholdings it has selected for rebuttable control determinations, coupled with the revised control factors, are well within the parameters of situations where the Board and other bodies have found control to be present. The Board also concluded that the use of rebuttable control determinations in this fashion was crucial to its ability effectively to implement the *prior* review process which is at the heart of the purposes of both Acts.

The Board further notes that the second threshold for a rebuttable determination, which arises from the acquisition of non-voting stock, provides that an acquiror will be deemed to control an insured institution upon acquiring more than 25 percent of *any* class of stock of the insured institution, if the acquiror is also subject to any control factor. Again, the Board believes this threshold, combined by the revised control factors discussed hereinafter, is fully supported by its experience and is consistent with control concepts applied by other federal banking and regulatory agencies.

The Board received a comment concerning the interaction of the acquisition of stock of an insured institution and the existence of control factors regarding the timing of the existence of a rebuttable determination of control. Clearly, when an acquiror obtains a control factor prior to or simultaneously with the acquisition of stock which when combined would give rise to a rebuttable determination of control, the acquiror would be deemed to have gained control upon the purchase of the stock. However, the Board believes that a person or a company must also be deemed to have gained control of an insured institution when it holds an amount of stock in excess of a threshold amount and then subsequently obtains a control factor, irrespective of whether additional stock is then acquired. In the proposal, the Board specifically requested comment on the question of how much time should elapse between the acquisition of stock and the commencement of the existence of a control factor before an acquiror would no longer be deemed to have acquired control. One commenter opposed any device which would allow an acquiror to hold stock for a specified amount of time and thereafter obtain a control factor which would cause it to fall within a rebuttable determination of control, yet avoid notice or application procedures merely due to the passage of time. The Board agrees with this conclusion and, therefore, the rule relates the acquisition of a control factor back to the acquisition of stock so that a person or company will be regarded as having gained control of an insured institution upon obtaining a control factor irrespective of the passage of time since acquiring the requisite amount of stock.

In addition to rebuttable control determinations based on the ownership of stock, the proposed revisions contained rebuttable determinations based on holding revocable proxies. In the Board's experience, in certain situations a holder of revocable proxies may effectively cause a change of control of an insured institution or otherwise be capable of exerting a continuing controlling influence on the management and policies of an insured institution, and therefore, in those situations, the Board should have the opportunity to review the prospective change in control before it occurs, just as in the case of a change in control occurring through an acquisition of stock. Indeed, in a recent article, a noted commentator described a proxy contest as "an expeditious method of acquiring control." Lipton and Browstein, "Takeover Responses and Directors' Responsibilities—An Update, 40 *Bus Law* 1403 (Aug. 1985).

The Board notes that the literal language of both the Holding Company Act and the Control Act covers the holding of proxies representing 25 percent or more of an insured institution's voting stock, regardless of the purpose of the proxy. See 12 U.S.C. 1730(a)(2) (A) and (B), 12 U.S.C. 1730(q).(1).(8)(B) and (13). Rather than apply the statutes in so broad a manner, however, the Board has elected to treat the holding of revocable proxies representing 25 percent or more of a class of voting stock as giving rise to a rebuttable determination of control, and only so when the proxies relate to specified matters that are indicative of the proxy holder's ability to acquire and exercise effective control on a continuing basis. In so doing, the Board has sought not to unduly interfere in the corporate governance procedures of insured institutions, while at the same time protecting the Board's interest in scrutinizing changes on control before rather than after, they occur.

In its proposal, the Board included among the rebuttable determinations of control, the possession of revocable proxies representing 25 percent or more of any class of voting stock of an insured institution where such proxies (1) pertain to the election of a majority of the insured institution's board of directors; (2) pertain to the acquisition or corporate reorganization of the insured institution; or (3) would enable the proxy holder to exert a continuing influence on a material aspect of the business operations of the insured institution. The Board requested comments on other factors that would be appropriate for this control element and other ways in which control through proxies could be addressed in the final regulation.

The Board received several comments regarding its determinations of control based on the holding of proxies. One commenter raised the concern that the proposal would discourage proxy solicitations altogether because it would be impossible to receive Board approval of a holding company application in the time frame of a proxy contest. The Board notes that only certain specified issues arising in a proxy contest would give rise to a rebuttable control determination. Where proxies will be held in connection with a matter that is within the scope of the rebuttable determination, it is the Board's intention to make use of the expedited rebuttal process in order to speedily resolve whether an application or notice would be required. Finally, if an application or notice would be required due to the subject of the proxy solicitation and the lack of availability of a rebuttal, the Board believes that by specifying the circumstances when an application or notice would be likely to be required, prospective acquirors will be on notice and thereby have sufficient time to plan their conduct accordingly.

The Board also received several comments concerning the applicability of the control determinations to proxies solicited by management of the insured institution. The Board has clarified its position in this area by providing in the final regulation that revocable proxies solicited by or on behalf of management do not raise rebuttable control determinations as management is presumed to be exercising its fiduciary duty on behalf of the institution rather than acting in its own interest. Further, as management is currently, in one respect, in control of the institution, it generally is not subject to the Acts which regulate *changes* in control. In addition, the Board has clarified its previously stated position by indicating that the solicitation of proxies in opposition to a solicitation by management will not come within the scope of the rebuttable control determination. It is the Board's belief that shareholder democracy should not be unduly restricted and, indeed, that to do so may not be in the best interests of an institution, and that a solicitation in opposition to a management solicitation need not be an attempt to achieve effective control of the institution. It is noted, however, that a solicitation concerning election of directors which is in opposition to a management solicitation is not totally excepted and may give rise to a rebuttable control determintion where it would enable an acquiror to hold one-third or more of the seats on the board.

Another commenter requested that the Board clarify the inclusion of voting stock and irrevocable proxies together with revocable proxies in this control category. The Board finds this request to be well founded, and the final regulation expressly includes voting stock and irrevocable proxies in the calculation, together with the amount of revocable proxies held. In a similar fashion, the final regulation clarifies the fact that the nominees or representatives of the acquirer who currently serve on the institution's board of directors must be included when considering the number of representatives of an acquiror on a board of directors.

Of the three issues to which revocable proxies must pertain in order to raise a control determination, the Board received comment primarily with regard to the factor pertaining to the election of directors. In the proposed revisions, the Board would have created a rebuttable control determination for any acquiror holding 25 percent of the revocable proxies which pertained to an election of a majority of the insured institution's board of directors. One commenter suggested that if an acquiror could elect a majority of the institution's board of directors, the acquiror would be subject to the conclusive determination of control at § 574.4 (a)(i)(iii). The Board notes that the proposal did not concern the ability of the proxy holder to elect a majority of the directors but rather the holding of proxies pertaining to that issue. Upon further consideration, however, the Board has determined that an acquiror will be deemed in control, subject to rebuttal, where voting stock and proxies would enable the acquiror to elect one-third or more of the institution's board of directors. It has been the Board's experience that an acquiror who can elect representatives constituting at least one-third of the board of directors generally is capable of exerting substantial direction over the management and policies of an institution. This would be particularly likely, for example, in the case of a staggered board where election of one-third of the board generally would cover all the candidates for election in that year. The Board also notes that this determination is subject to the rebuttal process. The final regulation also includes proxy holders who could cause the insured institution's stockholders to approve an acquisition or corporate reorganization of the insured institution, or enable the acquiror to exert a continuing influence on a material aspect of the business operations of the insured institution, as was set forth in the proposal.

D. Control Factors

As previously discussed, the proposal sought to define the power to direct the management or policies of an institution through the combination of an acquiror's ownership of stock and certain control factors. In the proposal the Board listed seven primary control factors and seven secondary control factors which described various relationships between an acquiror and an insured institution. The Board received several comments concerning the relative merits of each proposed control factor, and one comment concerning the concept of basing control on stock ownership coupled with control factors. This commenter favored the regulatory scheme and agreed with most of the Board's proposed control factors, but suggested that the distinction between primary and secondary control factors was complex and somewhat arbitrary. Upon further consideration, in connection with its reduction in the number of categories of rebuttable control, the Board has determined that it is no longer necessary to provide separate categories of control factors. Thus, in the final regulation, the Board has listed one set of control factors at § 574.4(c). These eight control factors are comprised of all of the primary control factors and one secondary factor from the proposal. Some control factors also have been modified from the proposed revisions in response to concerns raised by commenters, or to incorporate features of eliminated control factors.

In the final regulation, the control factors include situations in which: (1) The acquiror would be one of the two largest holders of any class of voting stock of the insured institution; (2) the acquiror would hold more than 25 percent of the total stockholders' equity of the insured institution; (3) the acquiror would hold more than 35 percent of the combined debt securities and stockholders' equity of the insured institution; (4) the acquiror is party to any agreement (A) pursuant to which the acquiror possesses a material economic stake in the insured institution resulting from a profit-sharing arrangement, use of common names, facilities or personnel, or the provision of essential services to the insured institution, or (B) which enables the acquiror to influence a material aspect of the management or policies of the insured institution, other than agreements to which the insured institution is a party, and where the restrictions are customary under the circumstances, and in the case of an acquisition agreement, the restrictions apply only during the period when the acquiror is seeking Corporation approval to acquire the insured institution, the agreement prohibits transactions between the acquiror and the insured institution and their respective affiliates without Supervisory Agent approval during the pendency of the application process, and the agreement contains no material forfeiture provisions applicable to the insured institution in the event the acquisition is not approved or not approved by a specified date; (5) the acquiror would have the ability, other than through the holding of revocable proxies, to direct the votes of more than 25 percent of a class of the insured institution's voting stock or to vote more than 25 percent of a class of an insured institution's voting stock in the future upon the occurrence of a future event; (6) the acquiror would have the power to direct the disposition of more than 25 percent of a class of the insured institution's voting stock in a manner other than a widely dispersed or public offering; (7) the acquiror and/or the acquiror's representatives or nominees would constitute more than one member of the insured institution's board of directors; or (8) the acquiror or a nominee or management official of the acquiror would serve as the chairman of the board of directors, chief executive officer, chief operating officer, chief financial officer or in any position with similar policy-making authority of the insured institution.

It has been the Board's experience that the presence of any of the above factors coupled with ownership of a substantial block of stock is strongly indicative that the acquiror has the power to exert control over an institution's management or policies. For example, the Board's first proposed control factor, status as the largest shareholder, constitutes a control presumption for a 10 percent owner under the Change in Bank Control regulations of the Federal banking agencies. See 12 CFR 5.50(e), 225.4(b)(2); 303.15(a) (1984). In the final regulation, the Board also has added the proposed secondary control factor pertaining to the two largest shareholders as a control factor. The Board believes that the second largest stockholder of an institution may well possess as much power as the largest stockholder, particularly if there is no substantial difference in their stockholdings or if the largest stockholder is essentially a passive investor. However, because this is a component of a rebuttable control determination, the Board expects, in a case where the largest shareholder is firmly in control of the institution to the exclusion of an investor who would be the second largest shareholder, that a rebuttal could be filed and considered. The board received no comment on this control factor.

The Board also regards substantial non-voting equity investments as an indication of control. When an investor supplies an institution with a substantial portion of its equity capital or otherwise provides it with substantial funds, it is difficult to avoid the conclusion that the institution will be greatly influenced by the investor. With very sizeable investments, such influence need not depend on express contractual arrangements or legal rights. Further, control is not limited to day-to-day management of an institution, but applies also to investors who are generally consulted regarding major decisions. Similar concerns have prompted the Federal Reserve Board to adopt a guideline of 25 percent of non-voting equity investments in banks with respect to control issues under the Bank Holding Company Act. *See Policy Statement on Non-Voting Equity Investments by Bank Holding Companies*, 12 CFR 225.143(d)(3) (1984). As evidenced by the second control factor, the Board considers ownership of 25 percent of stockholders' equity a reasonable threshold for total equity investments in insured institutions in light of the 25-percent control criterion employed with respect to companies under the Holding Company Act. *See* 12 U.S.C. 1730a(a)(2)(B).

Similarly, the third control factor, a 35 percent investment in the combined debt securities and stockholders' equity in an institution, would raise such assumptions of control. In the Board's experience, a substantial creditor is generally in a position to exert substantial continuing control over an institution. Related to this point, one commenter suggested that the calculation of 25 percent of stockholders' equity should include instruments which constitute net worth under the Board's regulatory accounting principles. Such a proposition would bring subordinated debentures within the 25 percent calculation of the second control factor. The Board has elected not to treat subordinated debt and other regulatory net-worth items as stockholders' equity under this test. However, the third control factor of 35 percent of the combined debt securities and stockholders' equity of an institution would include subordinated debentures.

The fourth control factor reflects the Board's concern with the various arrangements including standstill-type agreements used by potential acquirors in stake-out or other acquisition arrangements. In the usual case, an acquiror will make a substantial non-voting equity investment in a target institution and enter into an agreement designed to ensure that the target does not engage in activities inimical to the investor's interests. Often these agreements take the form of covenants by the target not to enter into new lines of business or otherwise vary its operations from present patterns. Other agreements are more interventionist, requiring consultation with the acquiror on policy questions or enabling the acquiror to direct the voting of certain shares. Many of these agreements supply the acquiror with substantial potential to control, if not actual control over, the affairs of the institution. This is clearly the case when an arrangement requires consultation and clearance on major business matters, but control can also arise from agreements requiring adherence to current business practices. The surrender of new business opportunities at the behest of the acquiror at least raises questions of control.

On the basis of these concerns, the Board proposed a control factor covering any agreement which enables an acquiror to influence the management or policies of an insured institution, other than certain specified agreements. The Board received a comment which suggested that agreements which "enable the acquiror to influence the management or policies of the insured institution" as stated in the proposal would fall within the conclusive control determination concerning actual control set forth at § 574.4(a)(3). In response to this comment, the Board has amended the description of an agreement constituting a control factor by clarifying the fact that only agreements covering a limited yet material aspect of the institution's business give rise to a rebuttable control factor. Included in the description of these agreements are incidents of material economic relations, such as profit sharing, use of common names, facilities or personnel or the provision of essential services. These criteria were secondary control factors in the proposed revisions although they were not necessarily required to arise in specific agreements between an acquiror and a target institution. Accordingly, the final regulation states that a control factor exists if: The acquiror is party to any agreement (1) pursuant to which the acquiror possesses a material economic stake in the insured institution resulting from a profit-sharing arrangement, use of common names, facilities or personnel, or the provision of essential services to the insured institution; or (2) which enables the acquiror to influence a material aspect of the management or policies of the insured institution, other than specified agreements, including acquisition agreements that meet certain criteria, which are exempted.

The Board recognizes in this regard that restrictive covenants may serve legitimate ends in merger or credit agreements or in investments that infuse additional capital into an institution, and does not wish to unduly restrict these uses. The regulations therefore provide that agreements imposing covenants, restrictions or requirements affecting the management, policies or operations of the institution would not constitute a control factor if (1) the institution is a party of the agreement, (2) the restrictions are customary under the circumstances, and (3) in the case of an acquisition agreement, (i) the restrictions apply only during the period when the acquiror is seeking regulatory approval for the acquisition, (ii) the agreement prohibits transactions between the parties or between a party or its affiliates and affiliates of the other party without the approval of the Supervisory Agent, and (iii) the agreement prohibits material forefeiture payments by the insured institution in the event of default if approval of the acquisition is not obtained or is not obtained by a specified date.

The fifth and sixth control factors concern the ability of an acquiror to vote more than 25 percent of a class of an insured institution's stock upon the occurrence of a future event and the power to direct the disposition of more than 25 percent of a class of voting stock, respectively. These factors further reflect the Board's concern with agreements used by potential acquirors in stake-out arrangements. Such arrangements clearly signal management that the acquiror has the ability to effect substantial changes in the operations of the insured institution. No comments were received concerning the ability to dispose of stock. One commenter did express the concern that a financing agreement which provided the lender with the right to vote the stock held as collateral upon default might be considered to provide the lender with the ability to vote stock upon the occurrence of a future event. The Board takes this opportunity to clarify its intent that default of a loan would not be a "future event" for purposes of the fifth control factor and notes further that the hypothecation of stock or its voting rights is entirely exempt from the approval process if the loan was contracted in good faith, in the ordinary course of business of the lender, as described more fully above. *See* § 574.3 (c)(1)(iii); (d)(1)(ii).

The seventh control factor concerns the acquiror's representation on the target institution's board of directors. In the proposal, where 25 percent or more of an institution's board of directors was comprised of representatives or nominees of the acquiror, a primary control factor would have existed. Any representation at all would have constituted a secondary control factor. Several commenters argued that a minority position on the board of directors would not of itself constitute control. While the Board does not necessarily disagree, it notes that rebuttable control determinations require an aggregation of a substantial block of stock with control factors and provide for use of the rebuttal process if actual control does not exist. Nonetheless, in response to points raised by commenters the Board determined to reformulate this control factor.

The issue of representation on the board of directors was considered in conjunction with the reconsideration of the agreement required of investors attempting to rebut a rebuttable determination of control. The Board has determined that an inventor may reasonably desire a seat on the board of directors in order to monitor its investment, without seeking, or being able to exert control. The Board is not persuaded, however, of the need to have more than one director representing an investor other than where that acquiror wishes to attempt to influence the management or policies of the insured institution. Accordingly, a control factor will exist when the acquiror and/or the acquiror's representatives or nominees would constitute more than one member of the insured institution's board of directors.

The eighth and final control factor set forth in the regulation concerns interlocking management between the acquiror or a company owned by the acquiror and the target institution. In the proposed revisions, the interlock factor was set forth as a secondary factor and included any management official of the acquiror or the institution. The Board received no comments on this proposed factor and has determined to retain the interlocking relationship as a control factor but to limit the officials of the insured institution who would be deemed to trigger the factor. A control factor now will be triggered only if the acquiror or a nominee or management official serves in the following positions with the institution: the chairman of the board of directors, chairman of the executive committee, chief executive officer, chief operating officer, chief financial officer or in any position with similar policymaking authority with the insured institution. It has been the Board's experience that where a substantial investor has established such high-level relationships with the institution, the investor generally is capable of influencing the institution's affairs. Further, the ability of the investor to place representatives in such positions of influence is often evidence of a result of the investor's controlling influence as well as the source of that influence.

E. Rebuttable Presumptions of Concerted Action

In order to clarify the question of when persons or companies will be deemed to be acting in concert, the regulation specifies several situations which give rise to rebuttable presumptions of action in concert. These presumptions are derived both from longstanding precedents interpreting the term and from the Board's practical experience. Particular questions have arisen in this area, for example, regarding the extent to which a company may be deemed to be acting in concert with its management officials or controlling shareholders. The Board has confronted a variety of situations in which persons owning voting stock in an insured institution also controlled companies that had invested in securities of the same institutions or had otherwise taken actions which would result in the acquisition of influence over the affairs of the institution. Consequently, the influence of the management official or controlling shareholder was enhanced by the actions of his controlled corporation. Such arrangements can also lead to the types of unfair affiliated transactions that are a major concern of the Holding Company Act.

In the Board's view, when a person acquiring shares in an insured institution is a controlling shareholder or management official of a company that has made similar investments or has otherwise facilitated his acquisition, it is reasonable to assume that investments or actions of the company are the result of a common design. A coordination of action may result either from the controlling influence of the shareholder over the company or the fiduciary duty of the controlling shareholder or management official not to act against the interests of the company and its other shareholders.[9] To embody this principle in the regulations, the rule establishes presumptions that a company is acting in concert with a controlling shareholder or management official of such company where both the person and the company have certain specified relationships with the institution or have interests in the institution's stock. For instance, a controlling shareholder is presumed to be acting in concert with his controlled corporation if both own stock in an insured institution. If the company directly finances the acquisition of stock or is instrumental in obtaining financing for the stockholder through the pledging of its assets or other means, the stockholder also is presumed to be acting in concert with the company. A person is presumed to act in concert with the members of his immediate family as that term is defined at § 574.2(g). Persons who have specified business affiliations, in addition to their ownership of the stock of the institution in question, are deemed to act in concert in the purchase of the insured institution's stock. A purchaser of an insured institution's stock also is presumed to act in concert with any person who finances such purchase. Other business affiliations such as companies under common control and persons or companies that constitute a group for purposes of certain provisions of the Exchange Act regarding beneficial ownership reporting requirements and "participants" in proxy contests also are presumed to act in concert. *See* 17 CFR 240.13d-5(b)(1); 17 CFR 240.14a-11(b) (1982). Finally, as previously discussed in the description of the definition of the term "acting in concert", the Board presumes that a person or company acting in concert with a third party will act in concert with anyone else who also acts in concert with such third party. These presumptions are not conclusive and, as described below, are subject to a rebuttal process.

In its proposed revisions, the Board has limited one of the presumptions of concerted action between a company and its controlling shareholder to instances in which credit is provided by the company on other than arm's length basis. One commenter pointed out that the lending company would be required to place its assets in a position of risk for the benefit of its shareholder irrespective of the terms of the credit. The Board is persuaded by this argument and, accordingly, has provided in the final regulation that all extensions of credit from a controlled corporation to its controlling shareholder would raise the presumption of concerted action.

The Board received another comment which suggested that whenever social, family or business relationships exist or when any communications concerning the stock or management of the institution have occurred, concerted action should be presumed to exist. The Board believes that such a treatment would be too broad and would encompass groups where concerted action need not, typically, be present. The presumptions of concerted action adopted in the final regulation are limited to circumstances which in the Board's experience have evidenced concerted action. The Board notes, however, that persons or companies may also be found to be acting in concert whenever their actions are within the scope of the general definition of acting in concert at § 574.2(b), and that the presumptions of concerted action are not an exclusive statement of when concerted action may be deemed to exist.

In the description of the proposed revisions, the Board noted that the acquisition of stock by an employee stock ownership plan ("ESOP") raises control and other issues under the Holding Company Act. The Board has determined not to specify a presumption of concerted action based on the ownership of the stock by an ESOP at this time. The Board, however, has determined to codify its longstanding determination that a person or company is presumed to act in concert with any trust for which such person or company serves as trustee.

Finally, the Board takes this opportunity to reiterate its position concerning the ability of directors acting as a group to exercise control over the institution. It has been a longstanding position of the Board that directors are not considered to be acting in concert to control an institution solely on the basis of their position as directors. In the event directors attempt to direct the policies for the institution for their personal benefit, a group may deem to be formed which would require a filing of a notice of change in control pursuant to the Control Act and implementing regulations thereunder.

F. Rebuttal Procedures

Acquirors subject to determinations of control set forth in § 574.4(b) or concerted action presumptions set forth in § 574.4(d) are entitled to attempt to rebut such determinations or presumptions in accordance with the specific procedures established in the regulations. Section 574.4(e) establishes specified procedures for efforts to rebut the control determinations set forth in § 574.4(b) and the concerted-action presumptions set forth in § 574.4(d). In any instance in which a proposed acquisition would give rise to a rebuttable determination of control, the regulation requires that the acquiror either file the appropriate application or notice or submit written material attempting to rebut the determination of control and receive approval or acceptance thereof before proceeding with the acquisition. A rebuttal would set forth facts and circumstances supporting the absence of control. A control rebuttal submission also would separately include an agreement entered into by the acquiror with respect to certain types of activities.

In the Board's proposal this submission, modelled upon the rebuttal agreements that the Board has determined to be acceptable to date, would have included specific undertakings not to:

(a) Seek or accept any additional representation on the institution's board of directors;

(b) Have or seek to have any representatives serve on an executive or similar committee of the institution's board of directors;

(c) Engage in any intercompany transactions with the institution;

(d) Influence or attempt to influence in any respect the loan and credit decisions or policies of the institution, the pricing of services, personnel decisions, the location of any offices, or branching or similar activities of the institution;

(e) Influence or attempt to influence the institution's dividend policies and practices or any decisions or policies of the institution as to the offering or exchange of any securities;

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[9] The proposition that a company and its controlling person should be considered to act in concert finds further support in the Holding Company Act which prohibits officers, directors and 25-percent shareholders in a savings and loan holding company from acquiring control of other insured institutions. 12 U.S.C. 1730a(e)(2) (1982). This restriction was characterized as a complement to the Act's other curbs on holding company expansion rather than a limitation on directors, officers and 25-percent shareholders. H.R. No. 887, 90th Cong., 1st Sess. 14 (1967), *reprinted in* 1968 U.S. Code Cong. & Ad. News 1001, 1014.

(f) Have or seek to have any representative serve as an officer, agent or employee of the institution;

(g) Propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the institution's management or board of directors;

(h) Solicit proxies or participate in any solicitation of proxies with respect to any matter presented to the institution's shareholders other than in support of a solicitation on behalf of management of the institution;

(i) Seek to amend, or otherwise take action to change, the institution's bylaws, articles of incorporation, or charter;

(j) Exercise, or attempt to exercise directly or indirectly, control or a controlling influence over the institution's management, policies or business operations; or

(k) Vote stock owned or controlled with power to vote other than on a *pro rata* basis in accordance with the vote of other stockholders on matters presented to the stockholders; or

(l) Seek or accept access to any nonpublic information concerning the institution except when the acquiror is already represented on the board of directors.

The rebuttal agreement, however, would have allowed a noncontrolling investor or a representative or nominee thereof to engage in activities necessary to the performance of his duties as a member of the insured institution's board of directors. The rebuttal agreement permitted activities listed above regarding influencing credit decisions (d) or dividend policies (e), proposing directors (g), soliciting proxies (h), amending charter or by-laws (i), exercising a controlling influence (j), or obtaining non-public information where necessary solely in connection with an individual's performance of duties as a member of the board of directors.

These undertakings were based on rebuttal agreements currently employed by the Board under the current Control Act regulations, which are designed to ensure that an acquiror will not have the power to direct the management or polices of an insured institution and will not engage in the practices that the Control Act and holding Company Act were designed to prevent. A violation of the terms of the agreement would subject the signatory to such additional penalties, remedies and procedures as provided under applicable statutes or regulations for violations, willful or otherwise, of agreements with the Corporation.

The Board received numerous comments on the rebuttal procedure including several comments concerning specific provisions of the rebuttal agreement. Several commenters were concerned that while the rebuttal agreement would have the intended effect of ensuring that an investor would not be capable of controlling the insured institution, the agreement would go so far as to effectively strip investors of any voice in corporate affairs. One commenter suggested that such an extreme rebuttal agreement would insulate management from the discipline imposed by stockholders. The Board has carefully considered these comments and found a number to be persuasive. Thus, the rebuttal undertaking contained in the final regulation varies from that in the proposed revisions in two substantial areas, in addition to several minor clarifications. First, an acquiror may successfully rebut a determination of control and still be represented, either personally or by a nominee, by one member of the institution's board of directors. In accordance with the previous discussion concerning control factors, the Board believes that an investor may desire representation on the board of directors for reasons other than controlling an institution's management or policies. In order to accomplish this, the first restriction in the standstill agreement will allow representation by one director and the fourth restriction will allow an investor to propose one director if he is currently not represented on the Board.

The other major amendment to the proposed standstill agreement concerns the voting of stock owned by non-controlling investors. The Board has determined that voting of stock by an investor who, through the rebuttal process, has been determined not to be in control of the institution would be consistent with the Board's intent concerning rebuttal situations. The Board believes that once an investor is determined not to be in control of an institution and thus not capable of imposing his views on the management of the institution, there is no need to restrict that investor from reflecting his views by voting his stock. In fact, through the expression of interest by a substantial non-control investor, management of the institution will continue to be accountable to its actions. Thus, the provision of the proposed agreement concerning the requirement that a non-controlling stockholder vote its share on a *pro rata* basis has been eliminated. Similarly, the agreement has been modified to permit a party to solicit proxies, either in support of, or in opposition to a solicitation by management, except with respect to election of directors, which is treated separately. The Board also notes that unusual situations may require the use of modified rebuttal arrangements and expects that the rebuttal process will be sufficiently flexible to adapt to such situations.

Several commenters offered their views concerning the rebuttal procedure for control determinations. One commenter asserted that the rebuttal procedure would transform the notice procedure established by the Control Act into an approval procedure in contravention of Congressional intent. The Board notes that the rebuttal process is not mandatory; any acquiror may immediately file a notice of or application for a transaction which would fall within the specified control determinations. The rebuttal process is intended merely to allow an investor subject to a rebuttal control determination to demonstrate that it would not be in a position to exert control over an institution.

The Board notes that rebuttable control determinations are based on subjective statutory criteria concerning actual control, and that, in particular, the Holding Company Act provides that when control is determined on this basis, the Board must provide the acquiror with prior notice and an opportunity for a hearing. The rebuttable control determinations provided in the regulation give potential acquirors prior notice of what the Board generally considers actual control. Upon a determination by the Board or its delegate that the acquiror has not adequately rebutted the control determination, the acquiror should file the appropriate application. As noted previously, where acquirors subject to the Holding Company Act chose to proceed with an acquisition without filing and receiving approval of such an application, the Board has the firm intention to pursue such actions through additional administrative procedures.

The rebuttal process also would be available to a potential acquiror who would be determined to control an institution through the holding of revocable proxies, stock and irrevocable proxies, as described in § 574.4(b)(2). The Board recognizes that the rebuttal process would be somewhat different in connection with a determination of control that would arise as a result of holding revocable proxies. Therefore, in the case of a rebuttal of a determination of control of such type, the prospective proxy holder would be required to furnish such information as requested by the Corporation, potentially including a rebuttal agreement that would contain some but not necessarily all of the specified agreement restrictions. The particular information and undertakings required will also depend upon the issue for which proxies are being solicited that raises the control determination.

Similarly, presumptions of concerted action in § 574.4(d) would be subject to rebuttal. The person or company presumed to be acting in concert may seek to rebut the presumption by filing a statement setting forth the facts and circumstances that support the assertion that no action in concert exists. Such a statement is required to be accompanied by an affidavit from each person or company seeking to rebut the presumption of concerted action, stating that such person or company has no agreements or understandings, written or tacit, with respect to exerting control, directly or indirectly, over the management or policies of the insured institution, including arrangements with respect to voting, acquisition or disposition of the insured institution's stock. The Board is not required to accept an attempted rebuttal which is inconsistent with facts known to it, or which, in the view of the Board or its delegate, fails to clearly and convincingly refute the presumption of concerted action. As with attempts to rebut a determination of control, the rebuttal must state that a violation of its terms would subject the signatory to such additional penalties, remedies and procedures as provided under applicable statutes or regulations for violations, wilful or otherwise, of agreements with the Corporation. The Board also notes that execution of a false affidavit submitted to the Corporation may subject the person or company filing such an affidavit to criminal sanctions, see, e.g., 18 U.S.C. 1001 (1982), would be in violation of the Board's regulations, see 12 CFR 563.18(b), and would be considered a "presumptive disqualifier" if the party filing the false statement ever filed an application or notice, see § 574.7(b)(1)(v).

Rebuttal submissions must be submitted to both the Board's Office of Examinations and Supervision and Office of General Counsel; those Offices jointly have delegated authority to enter into control rebuttal agreements and to accept acting-in-concert rebuttal submissions on behalf of the Corporation. Within 20 calendar days of the submission of a rebuttal proposal, the filer will be notified either that more information is required or that a determination has been made to accept or reject the rebuttal. If notification is not received within the 20 day period, the rebuttal will be deemed to be accepted.

G. Safe Harbor

The regulation specifies a safe harbor which is available to passive investors whose interest in an insured institution does not fall within control determinations specified in § 574.4 (a) and (b). By providing a regulatory endorsement of certain arrangements, the Board hopes to encourage investments in insured institutions. The safe harbor is available where an acquiror owns less than 25 percent of an institution's voting stock, no control factors are present, and the acquiror agrees to abstain from soliciting proxies from others, although the acquiror may vote freely and dissent with respect to its own stock. In order to avail itself of the safe harbor, an acquiror must simply certify to the Board that its ownership status meets the requirements of the safe harbor and that, before changing that status, the acquiror will either file and obtain acceptance of a rebuttal or file and obtain approval of the appropriate notice or application. In order to clarify the requirements of this filing, the specific text of the safe-harbor certification is contained in § 574.4(f)(1) of the regulation.

The Board received several comments with respect to the inclusion of the safe harbor provision in the regulations. One commenter was unsure whether the safe-harbor certification must be filed by all investors who are able to file it. The Board notes that the filing is not mandatory but rather is available to investors who seek the certainty that their investment complies with the Board's regulations under the Control and Holding Company Acts. Another commenter contended that the safe-harbor concept is naive and should be eliminated, asserting that any investor who owned 24.9 percent of the stock of an institution could not be passive. The comment evidences a lack of comprehension of the Board's overall regulatory scheme regarding control of insured institutions. It has been the Board's experience that in certain situations, an investor may own up to 24.9 percent of an institution's stock and not be capable of controlling the institution. For example, a 24.9 percent stockholder could not avail itself of the safe harbor provision unless it was not one of the two largest stockholders of the institution.

The Board also received comments which were concerned that in order to qualify for the safe harbor, the passive investor would be required to relinquish its rights as a shareholder. The Board notes in this regard that a passive investor would be able to vote its stock freely, and thus does not agree with the commenter's characterization of the safe harbor.

Certification of Ownership and Other Reports

1. Certification of Ownership

A key element in the proposed revisions was an effort by the Board to provide a regulatory system that would facilitate the monitoring of compliance by investors with both the Control and Holding Company Acts in order to apprehend violators of the statutes. In an attempt to fulfill this goal, the regulations include a requirement that any person or company must file a brief certification upon the acquisition of 10 percent or more of any class of stock of any insured institution. Such a certification is required from the beneficial, not record, owner of the stock and simply identifies the insured institution and recites the fact that the acquiror owns 10 percent or more of any class of stock of the institution, that the acquiror is not currently subject to a rebuttable or conclusive determination of control and that the acquiror will not take actions that would give rise to a rebuttable determination of control under § 574.4(b) or a conclusive determination of control under § 574.4(a) without first filing and obtaining approval of a rebuttal or an application or notice, as appropriate. To make this filing as easy as possible, the specific text of the certification is set forth in the regulation.

This certification is not required to be filed by an acquiror that received Board approval of its acquisition under the Holding Company Act or if the acquisition was consummated after the expiration of the review period specified in the Control Act regulations. Acquirors that have filed materially complete applications or notices also are not subject to the filing requirement. Further, certifications need not be filed by an investor that owns stock of an insured institution upon the effective date of the regulation until such time as the investor acquires any additional stock.

The purpose of the certification is to provide the Corporation with notice of persons and companies that have amassed substantial amounts of the stock of an insured institution and thus are capable of acquiring control under the Board's regulations. The certification also allows the Board to obtain a commitment from such persons or companies that in the future they will observe the requirements of the regulations. The Board will not review the qualifications or resources of a

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person or company upon the filing of such a report and the report will not be treated as an application or notice for purposes of commencing statutory or regulatory time periods. The Board, however, will consider the report in connection with any Control Act notice or Holding Company Act application which would be required if the acquiror proceeds to acquire more stock or takes on more indicia of control. Accordingly, failure to file the notice or the filing of an inadequate notice could be taken into consideration should the acquiror be required to file a full notice or application. *See* 12 U.S.C. 1730(q)(7)(E) (Corporation may disapprove Control Act Notice for failure to file required information); 1730a(e)(1)(B) (Corporation need not render decision on application until 90 days after submission of complete record to Board) (1982).

Comments were received suggesting that the Board prohibit the filing of certifications by record holders of stock and that the Board require filing of the certification upon the acquisition of nonvoting as well as voting stock. The Board notes that it intended, in the proposed revisions, to require filing of the certification by *beneficial* owners and will not accept a filing in a "street name" by a mere record holder. Further, the final regulation has been clarified to indicate that ownership of 10 percent of any class of stock of an insured institution will trigger the filing requirement of a certification.

The certification is not a public document and is intended to assist the Board in its examination function. Several commenters requested that the Board make the certification a public document in order that institutions would be able to supplement the Board's efforts in monitoring compliance with the Act. The Board is not persuaded that the enhanced monitoring would offset the negative impact upon the flow of capital into the thrift industry caused by non-controlling investors' reluctance towards public disclosure of their stock holdings.

B. Reports on Loans

Paragraph (b) of § 574.5 would have implemented the Control Act requirements of notice to the Corporation whenever an insured institution or insured bank makes a loan secured or to be secured by 25 percent or more of the stock of an insured institution, 12 U.S.C. 1730(q)(9) (1982), by redesignating an analogous provision which appears in the current regulations at 12 CFR 563.10-3(c) (1985). Statutory exceptions are provided for loans where the borrower has been the owner of record for more than one year or where the stock is that of a newly organized institution prior to its opening. The notice required by this paragraph also is confidential and consists of a statement identifying the insured institution, the amount of stock involved, the date of the loan, and the name of the borrower. The Board notes that it is authorized to require additional information, but believes it is able to monitor such loans on the basis of information required by the regulation. *See* 12 U.S.C. 1730(q)(10). No comments were received on this provision. Upon further consideration of the statutory basis for this filing, the Board has specified in the final regulation that the filing must be made by the president or other chief executive officer of the lending institution.

Procedural Requirements

The Board has compiled the procedural requirements for all aspects of acquisition of control transactions in section 574.6. These provisions are designed to implement the substantive revisions to the regulations discussed herein and to better coordinate and facilitate the increased use of delegated authority in the application and notice processes.

A. Applications and Notices

Section 574.6(a) sets out the proper form to be used by particular acquirors for Board review of an acquisition of control of an insured institution. As is currently the case, the type of application required of a company will depend on whether the acquiror is currently a savings and loan holding company with respect to an insured institution and the type of acquisition transaction proposed. The applications, as currently described in 12 CFR 584.10, have not been revised at this time, although the Board expects to revise certain portions of the applications and notice forms in the future in order to incorporate newly defined methods of obtaining control and to facilitate the proposed new public notice procedures.

Companies which are not currently savings and loan holding companies must file Form H-(e)1 for acquisitions of control of a single insured institution. Acquisitions of control of a single insured institution by an existing savings and loan holding company and acquisitions of control of more than one insured institution by any company, including a savings and loan holding company, require use of Form H-(e)2. Form H-(e)3 is used in the same instances as would require a Form H-(e)2 except that the proposed transaction involves the merger of an insured institution or existing savings and loan holding company rather than an acquisition of stock. Companies that acquire control in a reorganization which is exempt from the Board's prior approval pursuant to § 574.3(c)(1)(ii) file the Form H-(e)4 informational filing in order to claim exempt status. Persons seeking to acquire control of an insured institution shall continue to use the Change in Savings and Loan Control Act Notice Form 1173, Parts A and B. The Board received no comments on the applications and notice required to be filed, and these provisions were adopted as proposed.

Section 574.6(b) sets out the filing procedures for the previously described applications and notices, detailing the proper place of filing and the number of copies to be filed. The Board has amended its proposal to facilitate the use of expanded delegations of authority. An acquiror that believes its acquisition to be eligible for approval under delegated authority is required to file two copies of the application or notice with the Principal Supervisory Agent. Such filing must include a brief summary of the proposed transaction, including a statement as to why the proposed acquiror asserts the notice or application may be processed under delegated authority, and an affirmative statement that none of the factors specified in § 574.6(a)(1) which would preclude action under delegated authority are present. Such statement must be clearly labeled "Statement Regarding Eligibility for Processing Under Delegated Authority." The Board believes that an acquiror that makes an accurate claim for review under delegated authority will have its application or notice processed more expeditiously. Filing procedures for non-delegated applications and notices also are specified.

Section 574.6(b)(4), concerning the circumstances in which an application or notice may be amended, has been altered from the proposed revisions where it was set forth at § 574.6(b)(3). Additional information may be filed in an amended application or notice upon the applicant's own initiative as well as upon the request of Supervisory Agent. The Board believes that additional information should be filed if it would materially affect the Board's determination. In the event that the Board determines that the amendment would alter materially information which is available to the public, the staff may require the applicant to republish the notification required at § 574.6(d). Subparagraphs (5) through (8) specify the manner in which documents required by the regulation including rebuttals, safe-harbor claims, 10 percent ownership certifications, and reports on loans secured by stock, respectively, must be filed with the Board. The Board received no comments on these filing requirements.

B. Sufficiency of Filings

The Board has specified, in § 574.6(c), that an application or notice will be deemed sufficient upon inclusion of all information specially called for in the appropriate form of application or notice (unless waived in accordance with the provisions of such form) as well an any additional information the Corporation or its delegate may require by specific written request in connection with a particular notice or application. The regulations require a complete description of all proposed acquisitions. In many instances, the responses to the items in the forms may raise additional issues on which the Board needs information before it can properly evaluate a notice or application. The reservation of the power to make additional inquiries enhances the Board's ability to conduct thorough investigations of acquirors. Further, the Board may need to make further inquiries of the acquiror on the basis of information received from public comments. In order to expedite the review process, however, the regulations provide that once additional information has been requested, no further information may be requested unless the subsequent request is derived from or prompted by information already furnished, involves material information previously concealed or which was otherwise unavailable, or pertains to developments that have occurred subsequent to the original request for additional information. In addition, the Board wishes to note that once a notice under the Control Act has been found to be sufficient for purposes of commencing the 60 day period of review, only the Board may cause the review period to be halted and commenced again.

The regulations require the Board or its designees to make a determination as to the sufficiency of a particular notice or application within 10 business days of the close of the comment period described in subparagraph (e), or extension thereof. Upon the expiration of such 10 day period, a notice or application will automatically be deemed sufficient unless additional information has specifically been requested in writing by that date. If additional information is requested, the Corporation or its designee must make a determination as to its sufficiency within 10 business days of the timely filing of such requested additional information, or the filing automatically will be deemed to be sufficient.

In an effort to further expedite the application and notice review process the Board has implemented an internal application tracking system which, among other things, contains deadlines for completion of certain review functions by the Board's staff. The Board expects that factors such as the 10-day period to determine sufficiency, the focusing of requests for additional information and the new tracking system should result in a streamlined review procedure with expedited determinations. The Board also believes, however, that applicants have a responsibility to respond expeditiously to request for additional information in connection with their submissions and that undue delay in this respect unfairly burdens the Board's resources. Therefore, the regulations also specify that a failure to respond to a request for additional information will, after 30 days, be deemed to constitute withdrawal of an application or notice.

In order to clarify the appropriate review functions, the final regulation expressly provides that the commencement of a review period is affected by actions of the Principal Supervisory Agent or his delegate only with regard to applications or notices which the PSA may approve or disapprove as provided in § 574.8(a). The regulation sets forth a 30 day automatic approval provision for exempt holding company reorganizations filed on Form H(e)-4 pursuant to the approval exception in § 574.3(c)(1)(ii). Finally, section 574.6(c) reserves the right of the Corporation to waive information requirements in supervisory cases or which are otherwise determined to be unnecessary. The Board received no comments on its determinations regardings sufficiency and waiver.

C. Newspaper Publication

Section 574.6(d) sets out the newspaper publication required of acquirors filing Holding Company Act applications and Control Act notices. The regulation reconciles the currently substantially different approaches to the publication requirements in the current implementing regulations. The Holding Company Act regulations now require applicants to publish notice of their filing within 10 days after being notified by the Supervisory Agent that the application is complete. 12 CFR 584.4(e) (1985) (incorporating by reference procedures of 12 CFR 543.2(d)). Upon publication, the application and related communications become publicly available except to the extent disclosure is exempted by the Freedom of Information Act, 5 U.S.C. 552 (1982). See 12 CFR 543.2(d)(4) (1985). On the other hand, the current Control Act regulations specify that notices are for the use of the Corporation and appropriate state supervisors and cannot otherwise be disclosed except in accordance with the Board's regulations implementing the Freedom of Information Act, 5 U.S.C. 552 (1982), and the Privacy Act, 5 U.S.C. 553a (1982). *See* 12 CFR 563.18-2 (1985).

As originally promulgated, the Control Act regulations were silent as to the public availability of notices. *See Amendments Relating to the Change in Savings and Loan Control Act of 1978*, Board Resolution No. 79-121, 44 FR 10500 (Feb. 21, 1979). In 1980, the Board amended the regulations to provide that except for confidential portions, notices would be available for public viewing. *Federal Savings and Loan Institutions, Change in Control*, Board Resolution No. 80-491, 45 FR 55693, 55696 (Aug. 21, 1980) (See former § 563.18-2(e)(4)). In addition, the target institution was given special notice of the filing of a Control Act notice or a rebuttal of a control presumption and a period of 10 or 20 days (depending on the type of filing) in which to submit its views regarding the acquiror. 45 FR at 55695-96 (former § 563.18-2(c)(3) and (f)).

In Resolution No. 82-507, dated July 29, 1982, however, the Board determined to delete the provisions for special notice to the target institution and to further specify that notices would be kept confidential. *Amendments Relating to Change in Control*, Board Resolution No. 82-507, 47 FR 34120 (Aug. 6, 1982). This change in approach was prompted by concerns that disclosure of notices could prematurely and materially affect the public trading price of the institution's securities and thus complicate acquisitions of insured institutions. 47 FR at 34122. It was also noted that in the case of a proposed tender offer the potential acquiror also may be required to make certain disclosures as if a tender offer had commenced as of the filing date, even though it actually had not. *Id. See* Exchange Act Rule 14d-2, 17 CFR 240.14d-2 (1984) (Public disclosure of identity of bidder and target, amount of securities sought, and price to be paid deemed commencement of tender offer). Interpretative Release Relating to Tender Offer Rules, Release No. 34-16623, 45 FR 15521 (Mar. 11, 1980); 3 Fed. Sec. L. Rep. (CCH) 24,2104 (Mar. 5, 1980) (Public filing with federal agency can trigger tender offer).

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Although the Board continues to acknowledge these concerns, it is also of the view that a better balance can be struck between the needs of acquirors for confidentiality and the Board's interest in obtaining all information that may be of value in its review process. The Board finds that public participation in the applications process can be helpful in the execution of its duties, particularly in bringing to its attention information that would prevent acquisitions of control of insured institutions by unqualified or dishonest acquirors. Moreover, the Board notes that in adopting the Change in Control Act, Congress compared control acquisitions review to that exercised over charter applications, mergers branching and other transactions in which public notice has long been a feature. *See* H.R. Rep. No. 1383, 95th Cong. 2d. Sess. 19 (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 9291.

The final regulation institutes a uniform publication procedure for Holding Company Act applications and Control Act notices. Section 574.6(d)(i) directs acquirors to follow procedures which have been modified from those currently required of holding company applicants in 12 CFR 543.2(d). Every acquiror is required to publish notification of a proposed acquisition of control of an insured institution within 10 calendar days of filing an application or notice. The public notification, in the form prescribed in the regulation at § 574.6(d)(2), must be published in the business section of a newspaper having general circulation in the community in which the institution's home office is located. The notice must contain only the basic information on the name of the prospective acquiror, the institution whose stock is sought to be acquired, and the date of filing of the acquiror's application or notice. The public notification also includes information concerning the procedures and deadlines for commenting upon the filing and where the application may be reviewed. Applicants are required to mail a copy of the public notification to the institution whose stock is sought to be acquired. Copies and a publisher's affidavit of publication must be filed promptly after publication.

Upon publication, non-confidential portions of an application or notice become publicly available. An acquiror may claim confidentiality for portions of an application or notice, including information that the acquiror asserts would trigger the commencement of a tender offer under Exchange Act Rule 14d–2. Price or other terms of an acquisition as well as personal financial information also may be excluded from disclosure on the basis of personal privacy or business confidentiality, if confidential treatment is requested in accordance with the procedures described in the regulation. In the Board's review, the disclosure required by the proposal should not upset trading or disadvantage acquirors and should not, of itself, be deemed to trigger the commencement of a tender offer under Exchange Act Rule 14d–2. In any event, information which will be disclosed pursuant the regulation may now be obtained by any party through requests under the Freedom of Information Act.

The Board also notes that since it proposed to implement public notice requirements under the Control Act, both the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation have adopted the approach proposed by the Board and have proposed similar amendments to regulations under the Change in Bank Control Act of 1978, 12 U.S.C. 1817(j), which would also require public notification of proposed acquisitions of control of banks under their respective jurisdictions. *See* 50 FR 19183 (May 7, 1985); 50 FR 41361 (October 10, 1985).

The Board received five comments on its proposal to require public notification of notices of change in control. Four of the commenters strongly supported the Board's proposal on the basis that increased input from the target institution and the general public would enhance the Board's ability to render determinations in accordance with criteria enumerated in the Control Act and the Holding Company Act. The commenter who opposed expanding the publication requirement to Control Act notices asserted that the Control Act procedures would be unduly disrupted, and publication would present management with another weapon against potential acquirors. The Board disagrees with these assertions and does not believe that the public notice provisions will disrupt the Board's review process. While the commencement of the review period would be delayed slightly until the close of the public comment period, the Board has provided other limitations in the review process which should result in acquirors receiving a more expeditious determination of Control Act notices than under the current regulations. These limitations include restriction of the scope of and time for requesting additional information, the limitation on the time provided to determine sufficiency and the requirements that the Board, rather than its staff, approve any recommencements of the review period, as well as the Board's newly implemented internal applications tracking system.

Due to the minimum information regarding the details of a proposed acquisition that will be disclosed, management of an insured institution will be provided only with essential information concerning the name of acquiror and the date of the filing. In response to the concern of the commenter that management of a target institution may use the publication and comment process to unduly thwart the efforts of a potential acquiror, the rule has been amended to explicitly provide that the Corporation will not consider unverified accusations or materials which the respondent is unwilling to have disclosed to the acquiror, and that such materials, as well as materials filed after the expiration of the public comment period, will not be part of the record considered by the Board.

E. Public Comment

Section 574.6(e) sets out the procedural requirements for public comments to be filed in response to the required public notification, which are similar to the procedures used in connection with other applications filed with the Board found in 12 CFR 543.2(d). Comments submitted in connection with an application or notice would be considered part of the filing and release of information contained in comments would be subject to the same procedures and standards as would be applied to release of information contained in the application or notice. The Board received one comment which asserted that public comments must be accorded confidential treatment in order to avoid a chilling effect on potential commenters. Ironically, this commenter also made recommendations that rebuttal filings, certifications of ownership and other documents filed by acquirors be made public documents. The Board does not believe that public availability of comments will deter people from filing information. The Board has experience with the public comment provisions in Holding Company Act and other applications and is not aware of any disinclination to file information because such information is publicly available. In the final regulations, comments on an application or notice will continue to be disclosable in the same manner as information in applications or notices. In addition, as already noted above, in order to prevent distortion and manipulation of the public comment process to induce inordinate delays in the Board's review or to unfairly tilt the process in favor of either the acquiror or the target institution, the regulations specifically provide that comments received after the expiration of the comment period, unverified accusations or materials that the submitter is unwilling to have disclosed to the acquiror, shall not be part of the record and shall be considered by the Corporation.

F. Disclosure and Confidentiality of Filings

Section 574.6(f) sets forth the procedure for disclosure of material contained in an application or notice or other filing, as well as the procedure necessary for an applicant to obtain confidential treatment of any portion of an application or notice. Disclosure shall be made in accordance with the Freedom of Information Act and shall include all material for which confidential treatment has not been granted by the Board.

In order to obtain confidential treatment, an applicant must supply a request and justification for confidentiality at the time the notice or application or other submission is made which specifies the basis for confidential treatment of particular items. General, unspecific, all-inclusive requests for confidentiality will not be granted. Information for which confidentiality is requested must be clearly marked and segregated from other material. Thus, for example, an acquiror or commenter may submit a "confidential" and "Non-Confidential" set of its filing. The Board or its delegate may make a determination regarding the appropriateness of the assertion of confidentiality at the time a request for disclosure is made or any time prior thereto. Five business days notice will be provided to an applicant or other filer where the Board has determined to release information for which a claim of confidentiality has been made. The final regulation sets forth the information which must be supplied to the Board to substantiate a request of confidentiality, in § [illegible](f)(5). Included in the substantiation must be justification for the retention of information as confidential after the consumation of the proposed transaction. All approvals of confidential-treatment requests shall be considered to remain confidential until that time.

The regulation permits the waiver by the Corporation of the requirements of public notification, public comment and disclosure in supervisory cases. The Board received no comments concerning its provised revisions to disclosure and confidentiality requirements.

G. Private Rights of Action

In the preamble to the proposed revisions the Board discussed the role of the public in the Board's administration of the Control and Holding Company Acts. The Board believes, for example, that the new regulations which encourage public participation through the provision of information regarding potential acquirors will supplement the Board's efforts to compel compliance and enhance the Board's oversight of the acquisition process. Information supplied by a target institution is particularly beneficial because the target institution often is in the best position to detect concerted activity in the acquisition of its stock or the existence of other substantial stockholders who may be subject to one of the Acts.

The issue of the existence of private rights of action under the Acts is another area where the role of the public in the Board's administration of the Acts is presented. The Control Act and Holding Company Act neither expressly prohibit nor provide for an action to be brought by third parties to compel compliance with either statute. The Board is well aware, moreover, that the determination of whether a target institution—or even some other third party—should be found to have a private right of action is one that is made by the courts and is not decided simply by the Board expressing its views on the issue. However, because the Board believes that it would be appropriate to recognize limited private rights of action under both Acts the Board has respectfully concluded that it would be useful to set out its views on this issue.

In assessing whether a private right of action should be implied, the Board has considered the criteria articulated by the Supreme Court in *Cort v. Ash*, 442 U.S. 66 (1975). In *Cort*, the Supreme Court set forth four standards for determining whether a private right of action would be implied:

1. Is the plaintiff "one of class for whose *especial* benefit the statute was enacted," * * * that is, does the statute create a federal right in favor of the plaintiff?.

2. Is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one?.

3. Is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff?.

4. Is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

422 U.S. at 78 (emphasis in original).

The Board is aware that several federal district courts have reached conflicting results as to whether an implied private right exists under the Control Act or the Holding Company Act. With respect to at least the first three criteria articulated in *Cort*, the Board believes that factors weigh in favor of the existence of an implied right on behalf of a target institution to bring an action to compel the filing of an application or notice that may be required under either Act. The language of the Control Act and Holding Company Act provide the Board with authority to deny proposed acquisitions of control which "might jeopardize the financial stability of the *institution*." 12 U.S.C. 1730(q)(7)(c) (1982) or which "would be detrimental to the *institution* . . . ." 12 U.S.C. 173[illegible](e)(1)(B) (1982). Thus, the statutory language clearly indicates that the target institution is one of the class for whose "especial benefit" the statutes were passed. The Board notes that the parties most directly effected by the stability of an institution, its depositors, generally will be unlikely to possess the financial strength and cohesiveness and knowledge of a prospective acquiror's actions adequately to represent the interests of their institution in initiating an action against an acquiror that allegedly has violated one of the Acts. Thus, in practice, only the target institution generally will be in a position effectively to protect the rights of its depositors. *See GAF Corp. v. Milstein*, 453 F.2d 709, 719–21 (2d Cir. 1971) *cert. denied*, 4408 U.S. 901 (1972), *Florida Commercial Banks v. Culverhouse*, No. 84–5921 (11th Cir., October 7, 1985).

The Board is not aware of any indication of explicit legislative intent either to create or deny a private right of action. However, the Board notes that since the passage of the statutes, several courts have found implied rights for target institutions under the Change in Bank Control Act as well as the Control Act. In 1982, after several of these cases were decided, Congress adopted extensive amendments to the federal statutes regulating financial institutions in this country. Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97–320, 96 Stat. 1469 (1982). Congress did not amend the provisions of the Control Act to bar private actions. The fact that Congress "left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 381–382 (1982).

Further, the Board believes that certain types of actions may be brought by target institutions consistent with the underlying purposes of the legislative scheme of the Acts. The Board is aware that courts interpreting the Change in Bank Control Act and Bank Holding Company Act (which are substantially similar to the Control and Holding Company Acts, respectively) have rejected suits by target institutions because it was felt that statutes looked solely to the relevant federal agency to make the determinations of whether acquirors were *qualified* to obtain control under the applicable statutory criteria. *See Financial Corporation v. Union Corp.*, No CV 80–RVK, slip op. at 10, 12 (C.D. Cal. Sept. 26, 1980); *see also Quaker City National Bank v. Hartley*, 533 F. Supp. 126 (S.D. Ohio 1981) (interpreting Change in Bank Control and Bank Holding Company Acts).

The Board does not disagree with such holdings, but believes it is important to distinguish the subject matter of the actions that may be brought by private litigants. The remedy sought is important in considering a private right of action exists. *See, e.g., Florida Commercial v. Culverhouse, supra*. Where the Board has not taken a position that an application or notice is *not* required, private actions to enjoin an acquisition prior to an application or notice being filed and acted on by the Board, as distinct from an effort to second-guess the Board's judgment on the merits of whether a particular acquiror is qualified, would appear consistent with the congressional purpose of bringing a broad range of control acquisitions under the Board's scrutiny. If a target is not allowed injunctive relief, an acquiror could circumvent the requirement of filing a notice or application before controlling purchases were made and thereby exercise control, thereby defeating the purpose of the Acts.

The Board believes that the rules adopted today specify with sufficient clarity when the filing of an application or notice is required, and thus that in situations where the Board has not taken a position as to whether an application or notice, is required, the presentation by a target institution in private litigation of the issue of whether an application or notice should have been filed should not normally involve a court in highly subjective determinations where agency expertise is extremely valuable. By contrast, the Board's determination on the merits of a particular application or notice is predicated on the agency's expertise and years of immediate experience review applications and notice and supervisory acquirors. Thus, the Board believes that any implied right of action should not be extended to include second-guessing of the Board's substantive decisions. Such a result, in the Board's opinion would be inconsistent with the purposes and overall scheme of both Acts and is not supported by an analysis of the *Cort* factors.

The Board received several comments on the existence of private rights of action to compel compliance with the Acts, all of which were of the belief that such rights do exist under the Acts.

Determination by the Corporation

A. Application Review Criteria

The criteria with which the Board evaluates applications and notices submitted pursuant to this Part are detailed in § 574.7. These provisions are designed to facilitate expanded use of delegated authority and to expedite the overall regulatory review process by clarifying standards that will be applicable in review of applications and notices. Paragraphs (a), (b) and (c) manifest the requirements of the Holding Company Act for approval of an acquisition of control of an insured institution. As set forth in paragraph (a), the Holding Company Act provides a slightly different standard for acquisitions of control of a single insured institution by a company which is not a savings and loan holding company than for other acquisitions by companies. The Board is required to approve an application for the initial acquisition of a single insured institution which is filed on Form H-(e)1, if the statutory criteria are met. As set forth in paragraph (b), other applications, filed on Form H-(e)2 or H-(e)3, *may* be approved by the Board if the statutory criteria are met. As part of its review of applications under paragraph (a), the Board must request and consider a report on the competitive factors involved in the transaction as required by the Holding Company Act at 12 U.S.C. 1730a(e)(2) (1982). The Board notes that in its experience a transaction which would be disapproved under the discretionary standard of paragraph (b), would generally also be disapproved under the standard of paragraph (a).

The substantive criteria used in considering all Holding Company Act applications are restated from the Holding Company Act in paragraph (c). *See* 12 U.S.C. 1730a(e)(2) (1982). The focus of the Board's inquiry regarding acquisitions by a company would continue to be whether the financial and managerial resources and future prospects of the company and institution involved are detrimental to the institution or the insurance risk of the Corporation, and in an H-(e)2 or H-(e)3 application, the convenience and needs of the community to be served. The Board wishes to emphasize, however, that unless an application specifically indicates that the acquiror intends to acquire less than 100 percent of an insured institution's voting stock, the application will be reviewed, and an acquiror's financial resources analyzed as if the acquiror seeks to acquire 100 percent of such stock. Where an application is so limited, the Board may condition its approval to such amount, in which case additional acquisitions could be made only if the acquiror sought to amend its original application.

As provided in the Holding Company Act, the Board's discretion is limited to the extent that it may not approve control acquisitions with monopolistic tendencies. 12 U.S.C. 1730a(e)(2)(A) (1982). Nor may the Board approve a proposed holding company acquisition which would substantially lessen competition unless the anticompetitive effects of the transaction are clearly outweighed by a greater service to the convenience and needs of the community. *Id.* at 1730a(e)(2)(B). The Board's discretion continues to be limited by the statutory prohibition against the creation of new multi-state savings and loan holding company networks and the expansion of existing multi-state holding companies into new states, except, in both cases, in accordance with the conditions set forth in 12 U.S.C. 1730(m) (1982). *Id.* at 1730a(e)(3). The Board received no comments on the criteria for review of holding company applications.

B. Notice Review Criteria

The procedures relating to the review of a notice submitted under the Control Act, now found at 12 CFR 563.18–2 (e)(3), (g), (h) and (i) (1985), are set forth in paragraphs (d) through (f) of § 574.7. Paragraph (d) restates the statutory criteria used to review a notice filed under the Control Act. *See* 12 U.S.C. 1730(q)(7). One commenter asserted that the criteria for review of a change in control notice are quite general and would provide the Board with unbridled discretion. As the criteria for review of Control Act notices merely restate the criteria found in the statute, the Board believes that such comment is unfounded. The Board, however, has

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provided "presumptive disqualifiers"—which are applicable under both Acts—in order to clarify the Board's interpretation of some of the general criteria used under either statue, as described more fully below. The Board notes that the Control Act permits but does not require the Board to deny a notice which does not comply with the statutory criteria.

Because the Control Act involves a notice procedure, a potential acquiror need not receive approval to consummate the acquisition but merely, as stated in paragraph (e), may await the conclusion of the 60 day review period, or an extension thereof provided by the Board in accordance with § 574.6(c)(2)(i). Such acquisition must be consummated, however, within one year of the conclusion of the review period and only in accordance with the terms and representations stated in the notice. Further, a material change in circumstances prior to the acquisition would require that an amendment to the notice to be filed and would reinstate the review period. Prior to the expiration of the review period or an extension thereof, the Board generally will provide a potential acquiror with written notice if it intends not to disapprove the proposed acquisition. As in the case of review of applications under the Holding Company Act, the Board wishes to emphasize that unless a notice specifically indicates that an acquiror intends to acquire less than 100 percent of an insured institution's voting stock, the notice will be reviewed, and the acquiror's financial resources analyzed, as if the acquiror seeks to acquire 100 percent of such stock. Where a notice is so limited, the Board may condition its non-disapproval to such amount, in which case additional acquisitions could be made only by amendment to the acquiror's original notice. Upon a written statement of non-disapproval from the Board or its designee, the review period is deemed to be accelerated and the transaction may be consummated immediately thereafter in accordance with any conditions set forth in the letter of non-disapproval. *See* 12 U.S.C. 1730(q)(1).

In the event the Board or its designee determines to disapprove a notice of change in control, the proposed acquiror will be notified in writing. As set forth in paragraph (f) of § 574.5, such notification will include a statement of the grounds for disapproval and a statement that the acquiror within 20 days of the receipt of such notice of disapproval may, if the disapproval was issued by the Principal Supervisory Agent pursuant to delegated authority, request review of such disapproval by the Corporation pursuant to § 574.6(a)(4), or, if such review is denied, or the disapproval issued by the Corporation, may within 10 days of receipt of the notice of disapproval, or notice of the Corporation's decision not to review the denial, request an administrative hearing under paragraph (4) of the Control Act.

C. Presumptive Disqualifiers

The statutory criteria employed by the Board in making determinations with regard to applications under the Holding Company Act and notices under the Control Act includes general concepts such as the "managerial and financial resources" or "competance and integrity" of an acquiror. Through its experience in administrating the Acts, the Board has encountered a variety of situations which have proved to be indicative that a potential acquiror may not meet the statutory tests. In an effort to facilitate the review process, the Board has collected these factors as "presumptive disqualifiers" in order to put potential acquirors on notice of the grounds upon which an application or notice may be disapproved unless adequately refuted by the acquiror.

Section 574.7(g)(1) sets out presumptive disqualifiers which may indicate a lack of integrity on the part of the acquiror. The Control Act specifies the integrity of an acquiring person or proposed management personnel as a factor the Board must consider in reviewing notices. 12 U.S.C. 1730(g)(7)(D) (1982). *See also* 12 CFR 574.7(d)(4). The Holding Company Act requires an acquiror to have the requisite managerial resources to obtain approval to acquire control of an insured institution. The legislative history manifests Congress' intent that the term "management resources" relate to management's integrity as well as competence. *See* H.R. Rep. No. 987, 90th Cong. 1st Sess. 6 (1967), *reprinted in* 1968 U.S. Code Cong. & Ad. News 1601, 1606 ("companies with management of doubtful * * * integrity would be barred from gaining control of an insured institution."). The factors which would give rise to a presumptive disqualification of a proposed acquiror on integrity grounds include criminal, civil or administrative judgments, consents or orders, and any indictments, formal investigations, examinations, or civil or administrative proceedings (excluding routine or customary audits, inspections and investigations) that terminated in any agreements, undertakings, consents or orders, issued against, entered into by, or involving the acquiror or affiliates of the acquiror, by any federal or state court, any department, agency, or commission of the U.S. Government, any state or municipality, and self-regulatory trade or professional organization, or any foreign government or governmental entity, against an acquiror or affiliates of an acquiror involving: (1) Fraud, moral turpitude, dishonesty, breach of trust or fiduciary duties, or organized crime or racketeering; (2) violations of securities or commodities laws or regulations; (3) violations of depository institutions laws or regulations; (4) violations of housing authority laws or regulations; or (5) violations of the ethical codes of a self-regulatory trade or professional organization. Such events would be relevant if they occurred during the preceding 10 years. Other presumptive disqualifiers concerning an acquiror's integrity include denial of an application or withdrawal of an application after notice of intent to deny an application relating to the organization or acquisition of control of a financial institution, the liquidation, conservatorship, or receivership of any depository institution of which the acquiror was a controlling shareholder or management official, conviction of a felony by the acquiror or any affiliated person or affiliate, or knowingly making any written or oral statement to the Corporation (or its delegate) in connection with an application, notice or other filing under Part 574 that is false or misleading with respect to a material fact or omits to state a material fact with respect to information furnished or requested in connection with such application, notice or other filing. Finally, applicants would be subject to presumptive disqualification, on integrity grounds, if they submit applications while they are in violation of either Act or the Board's regulations thereunder, unless the violation arises as a result of acquisition of an amount of stock or a control factor with respect to the insured institution where the acquisition of such amount of stock or control factor was beyond the control of the applicant.

The Board received one comment concerning integrity-related presumptive disqualifiers which objected to the inclusion of consent agreements or undertakings by acquirors as presumptive disqualifier because "inadvertent violations of technical regulations" would not necessarily impute a lack of integrity to the acquiror. The Board wishes to emphasize that these factors are presumptions which an acquiror may overcome through explanation in the application or notice

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It has been the Board's experience, however, that consent decrees or undertakings often involve more than inadvertent violations of technical regulations. Therefore, the final regulations continue to include consent decrees as presumptive disqualifiers.

The regulations also set out presumptive disqualifiers based on financial factors. The Holding Company Act provides the Board authority to deny any acqusition application if the proposed acquiror lacks the requisite financial resources. 12 U.S.C. 1730a(e)(1)(A); (2). The Control Act provides the Board with the authority to disapprove a notice filed on the basis of the acquiror's financial condition. 12 U.S.C. 1730(q)(8)(C). In the proposed revisions, the Board set out the following factors which would presumptively disqualify an acquiror: (1) With respect to a company, failure to agree in writing that the company will ensure that its subsidiary insured institution shall have, at the end of each calendar quarter, net worth at least equal to three percent of liabilities, plus the growth and contingency factors as determined in § 563.13 or such greater amount that may be required pursuant to § 563.13, and that, where necessary, the company will infuse additional equity capital in a form satisfactory to the Supervisory Agent and sufficient to effect compliance with its net worth maintenance undertaking; (2) liability for amounts of debt which, in the opinion of the Corporation, create excessive risks of default and pressure on the insured institution; or (3) a business plan projecting activities for the target institution that are inconsistent with economical home financing.

The Board received a number of comments which disagreed with its proposal to include the net worth maintenance agreement described in (1) above. Commenters were concerned that such a requirement would impede investment in the thrift industry. The Board notes, however, that Holding Company Act acquisition applications are currently susceptible to approval under authority delegated to the Principal Supervisory Agent only upon acceptance of the net worth maintenance agreement. Further, as a presumptive disqualifier, the net worth maintenance agreement could have been obviated upon reasonable justification of the acquiring company. Nonetheless, the Board has determined to return the net worth maintenance guarantee requirement to a standard of delegated approval and has modified the provisions of the guarantee as discussed below.

The Board received no comments on the factors concerning debt of the acquiror and business plans. The Board continues to believe that these two factors are key to an assessment of the merits of an acquisition proposal. In the former respect, for example, the Board has become increasingly concerned with the potential negative impact and pressures that effect an institution where the institution is acquired in a transaction where the acquiror is subject to substantial debt, or in a so-called "leveraged buy-out." The total absence of any business plan, or a business plan projecting activities inconsistent with economical home financing are also of serious concern to the Board. Accordingly, the debt and business plan factors remain as presumptive disqualifiers in the final regulation.

The existence of any of the above considerations in the case of any acquiror or affiliate of the acquiror may constitute grounds for denying a proposed acquisition if not adequately addressed by the applicant. In light of inquiries posed to the staff of the Board concerning the intended impact of the presumptive disqualifiers, the Board takes this opportunity to note that it has codified factors as presumptive disqualifiers in order to notify the public of concerns that the Board will raise in its review process. By putting acquirors on notice of potential problems, the Board intends to expedite the review process and limit time which would otherwise be spent during requests for additional information on these factors. The Board did not intend to indicate that an acquiror, subject to a presumptive disqualifier, need not apply to all. The Board intends rather that the burden be on the applicant to explain and satisfy the Board when a presumptive disqualifier is present. A potential acquiror must specifically address these factors by submitting materials indicating that, in the case of integrity-related factors, the conduct has ceased or has become irrelevant or otherwise should not warrant a denial or disapproval. A rebuttal in such situations may indicate, if appropriate, that the conduct has ceased, that steps have been taken to prevent a reoccurrence, and that there is a reliable indication that those steps have been effective, such as, for example, the passage of a meaningful period of time without repetition of the conduct. With respect to financial resource-related factors, the submission of an acceptable business plan obviously is one step that would assist in making the requisite showing to overcome a presumption of disqualification.

Delegations

A. Summary

As part of its effort to increase the speed with which applications and notices are processed, without sacrificing the quality of review, the Board proposed substantial amendments to its delegations of authority. The regulations provide a uniform system of delegations for determinations under both the Control Act and Holding Company Act. The delegation formula should increase the number of applications processed in the field and is intended by the Board to operate in conjunction with the other substantive revisions of the regulations to increase the overall efficiency of the application and notice processing system. The Board has already implemented internal processing deadlines to aid in achieving this result. Further, the Board would expect to actively review the functioning of the expanded delegation process through the use of post-audits to ensure that delegation accomplishes the Board's goal of expediting the acquisition process without sacrificing the quality of review that must remain crucial to fulfillment of the Board's statutory responsibilities under the two Acts.

B. Authority of Principal Supervisory Agent

The new delegations for the first time confer the authority to deny as well as approve applications. The Principal Supervisory Agent is granted the authority to approve every application or issue notice of intent not to disapprove every notice that does not fall within one of four specified categories. Authority is not delegated to the Principal Supervisory Agent in the event that the acquisition is proposed to be accomplished in connection with a transaction where certain disclosure documents are required to be filed under section 13 or section 14 of the Exchange Act. This reservation of authority reflects the fact that a disclosure document requiring review will be filed with the Washington staff in connection with such a transaction and that many such institutions are likely to present special issues because they are recently converted to stock form. Under such circumstances, an acquisition may raise particular concerns that should be addressed by the Board and its Washington staff. In addition, review of such acquisitions can be done more

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efficiently in the same office where the Exchange Act filings of such institutions are reviewed. The Board received no comments on this aspect of the delegation provisions.

The second instance in which reviewing authority would be reserved to the Board's Washington staff involves contested acquisitions of insured institutions due to the potential complexity of, and issues that may be presented in such transactions. An acquisition proposal is considered to be contested if opposed by management of the institution or a competing acquiror. The Board believes that review by its Washington staff will allow better coordination of any enforcement or litigation issues that could arise during the course of the review. While the Board received no comments concerning the contested acquisition delegation provision, it has, upon further consideration, determined to modify the proposed provision to require that where an acquisition is contested, all acquisition applications or notices with respect to such institution be reviewed by Washington staff. The Board believes that in the case where conflicting offers have been made to acquire an insured institution, both applications should be processed in a similar fashion.

The last area reserved from delegated authority in the proposal, concerns novel issues of policy or law which in the opinion of Board staff warrant consideration by the Board. In these cases, the Board itself will be provided the opportunity to make the determination. The Board received no comments on this aspect of the delegation proposals. The Board wishes to emphasize that it expects staff of the Federal Home Loan Banks to be in close contact with the Board's Washington staff to assess whether an application or notice presents a legal or policy issue that warrants review by the Board. In addition, the Board regularly advises the staff of the Federal Home Loan Banks of issues of concern to the Board through supervisory bulletins and communications from various Offices of the Board as well as the Board itself. The Board expects that applications presenting such issues will be referred to the Board. The decision as to whether a transaction should be reviewed by the Board is left to the discretion and expertise of staff. Failure to refer a matter to the Board would not provide a basis for challenging the final staff action.

The Board has determined to add a fourth criterion which would exclude from eligibility for approval by the Principal Supervisory Agent, any application by a company which declines to agree in advance to maintain the net worth of the target institution and not to cause the insured institution to declare dividends in excess of 50 percent of net income per year unless waived by the Supervisory Agent. These provisions currently are included in the Board's standards for delegated approval of Holding Company Act acquisition applications at 12 CFR 584.4(g)(1) (i) and (ii). In the case of an acquisition by a company, the Board believes that a holding company should serve as a source of strength to its subsidiary insured institution. *See Kaneb Services, Inc. v. Federal Savings and Loan Insurance Corporation*, 650 F.2d 78 (5th Cir. 1981).

As previously discussed, the requirement of the net worth maintenance agreement was proposed to be included in the regulations as a presumptive disqualifier. One commenter suggested that it would be unfair to require a company that owned only 10 percent of a class of voting stock of an institution to be liable for 100 percent of the institution's losses. While the Board believes that any company that has the power to direct the management or policies of an insured institution should be responsible for the performance of such institution, it is aware that such a requirement may hamper investments in the industry. Accordingly, the Board also has provided the Principal Supervisory Agent with authority to approve an acquisition of less than 50 percent of the voting stock of an insured institution upon a stipulation by such company that it will maintain its *pro rata* share of the institution's regulatory net worth requirement. It should be noted that a company which is deemed to control an insured institution on the basis of concerted action with individuals would be required to sign an agreement, but the individuals would not, although the company's net worth maintenance would be calculated with reference to the stock held by the company and those with whom it was deemed to act in concert. All parties to the agreement which results in a similar organization, as defined in § 574.2(i), would be liable in connection with the net worth maintenance agreement.

The Board also has given the Principal Supervisory Agent the authority to deny any application or disapprove any notice which the Principal Supervisory Agent has the authority to approve. Denials of applications and notices by the Principal Supervisory Agent may be appealed to the Corporation. A request for Corporation review of a denial would be required to be submitted to the Secretary to the Board, with copies addressed to the attention of the Director, Office of Examinations and Supervision, and to the General Counsel. The request for review must identify the party seeking review and specifically describe the action taken of which review is sought and the reasons why the denial by the Principal Supervisory Agent is believed to be erroneous, and would be required to be submitted within 20 days of the date of the action taken for which review is sought.

In order to facilitate the review process, the Principal Supervisory Agent also would have the authority to take action with regard to publication of notice, deeming filings to be sufficient or requiring additional information with respect to any notice or application which he has the authority to approve. Finally, as an additional step to expedite the approval process, the regulation delegates to the Principal Supervisory Agent the authority to waive the requirement for certain audited financial statements for an acquiror's proprietary interests in connection with filings under the Control Act, provided that specified substitute information is submitted instead. If such substitute information were not furnished, the Principal Supervisory Agent would not have delegated authority to waive the requirement. In this regard, difficulties have often arisen with respect to financial statements for sole proprietorships and closely held companies. Generally, certain substitute information has been considered acceptable. This information has included, with respect to each acquiring person or company, a statement as to the percentage of his or her net worth that the acquisition represents, the percentage of net worth, assets and income attributable to proprietary interests, and such alternative financial statements regarding proprietary interests as are available. In the past, the Board has allowed the submission of tax returns and unaudited financial statements for proprietary interests which amounted to less than 10 percent of an individual's net worth, income or total assets when the preparation of audited financial statements would prove a hardship. The Board wishes to emphasize that this waiver pertains to financial statements for an acquiror's *proprietary interests*, not to the statements of the acquiror's assets and liabilities and income and source of funds which are specifically required to be furnished by the Control Act, 12 U.S.C. 1730(q)(6)(B).

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C. Authority of Washington Staff

The Board's Washington staff is delegated authority to take any action with regard to applications or notices which are not delegable to the PSA except that the staff in its discretion may refer to the Board those transactions that raise a significant issue of law or policy and those involving non-standard net worth maintenance or dividend conditions. The Washington staff has not, however, been given denial authority in the review of applications and notices, but has been authorized to make a determination regarding rebuttals of control determinations or concerted action presumptions. One commenter suggested that this function be delegated to the PSA. The Board believes that due to the novelty of the procedure uniformity will be preserved by having all rebuttal determinations made in Washington, for the time being.

Finally, the Board wishes to take this opportunity to emphasize that the fact that an acquisition is contested does not, alone, cause it to be a matter that should be referred to the Board. The Board specifically intends to rely on the discretion and expertise of its staff to keep the Board informed and to refer applications or notices to the Board where unresolved legal or policy issues are present, which may, but need not, include contested matters. There is no process or procedure for petitioning the Board to cause the Board to take up such matters directly, and the Board does not intend to entertain such petitions. The Board believes that the portions of the rule adopted today concerning delegations fully address the issues that may arise and intends that these provisions be followed in all cases. Moreover, the Board believes that it would unfairly tilt and delay the acquisition process if all contested acquisitions were required to be decided by the Board alone.

D. Sole Authority in the Board

The Board has retained sole authority to approve or deny any application or notice which has been referred to the Board as presenting significant issues of policy or law, and applications or notices presenting non-standard net worth maintenance or dividend conditions.

The Board has also reserved sole authority in the Corporation to assess monetary penalties under the statutes. Finally, in order to insure the efficient use of time in the review period of a Control Act notice, the Board has reserved for itself the authority to recommence a review period under the Control Act after a determination of sufficiency has been made, or in cases where the acquiror has not furnished all the information required or where any material information furnished is substantially inaccurate.

Final Regulatory Flexibility Analysis

Pursuant to section 3 of the Regulatory Flexibility Act, 5 U.S.C. 603 (1982), the Board is providing the following final regulatory flexibility analysis:

1. *Reasons, objectives and legal bases underlying the final rules.* These elements have been discussed elsewhere in the "SUPPLEMENTARY INFORMATION" regarding the rule.

2. *Small entities to which the rules apply.* The rule will apply to all acquirors of insured institutions.

3. *Impact of the rules on small institutions.* This has been discussed elsewhere in the "SUPPLEMENTARY INFORMATION."

4. *Overlapping or conflicting federal rules.* These are not federal rules which duplicate, overlap, or conflict with the rules.

5. *Description of reporting and recordkeeping requirements.* Discussed elsewhere.

List of Subjects in 12 CFR Parts 563, 574, 584 and 589

Securities, Savings and loan associations, Savings and loan holding companies.

Accordingly, the Board hereby amends Part 563 and adds Part 574 to Subchapter D, and amends Parts 584 and 589 of Subchapter F, Chapter V of Title 12 of the Code of Federal Regulations, as set forth below.

SUBCHAPTER D—FEDERAL SAVINGS AND LOAN INSURED CORPORATION

PART 563—OPERATIONS

1. The authority for Part 563 continues to read as follows:

Authority: Secs. 401–406, 48 Stat. 1255–1260, as amended (12 U.S.C. 1724–1728, 1730), Reorg. Plan No. 3 of 1947, 3 CFR, 1943–1948 Comp., p. 1071, unless otherwise noted.

§ 563.18–2 [Removed]

2. Remove § 563.18–2.

§ 563.18–3 [Amended]

3. Amend § 563.18–3 by removing paragraph (c) and redesignating paragraphs (d), (e) and (f) as paragraphs (c), (d) and (e), respectively; and by amending newly redesignated paragraph (c)(1) by substituting the phrase "this § 563.18–3" for the phrase "paragraphs (b) or (c) of this section".

4. Add a new Part 574 as follows:

PART 574—ACQUISITION OF CONTROL OF INSURED INSTITUTIONS

Sec.
574.1 Scope of part.
574.2 Definitions.
574.3 Acquisition of control of insured institutions.
574.4 Control.
574.5 Certifications of ownership and other reports.
574.6 Procedural requirements.
574.7 Determination by the Corporation.
574.8 Delegations of authority.

Authority: 12 U.S.C. 1730(q); 12 U.S.C. 1730a(e).

§ 574.1 Scope of part.

The purpose of this part is to implement the provisions of the Change in Savings and Loan Control Act, 12 U.S.C. 1730(q) ("Control Act") and the Savings and Loan Holding Company Act, 12 U.S.C. 1730a ("Holding Company Act"), relating to acquisitions and changes in control of insured institutions that are organized in stock form and holding companies thereof.

§ 574.2 Definitions.

As used in this Part and in the forms under this Part, the following definitions apply, unless the context otherwise requires:

(a) "Acquire" when used in connection with the acquisition of stock of an insured institution means obtaining ownership, control, power to vote, or sole power of disposition of stock, directly or indirectly or through one or more transactions or subsidiaries, through purchase, assignment, transfer, exchange, succession, or other means, including:

(1) An increase in percentage ownership resulting from a redemption, repurchase, reverse stock split or a similar transaction involving other securities of the same class, and

(2) the acquisition of stock by a group of persons and/or companies acting in concert which shall be deemed to occur upon information of such group: *Provided*, that an investment advisor shall not be deemed to acquire the voting stock of its advisee if the advisor (i) votes the stock only upon instruction from the beneficial owner, and (ii) does not provide the beneficial owner with advice concerning the voting of such stock.

(b) "Acquiror" means a person or company.

(c) "Acting in concert" means:

(1) Knowing participation in a joint activity or interdependent conscious parallel action towards a common goal whether or not pursuant to an express agreement, or

(2) A combination or pooling of voting or other interests in the securities of an issuer for a common purpose pursuant to any contract, understanding, relationship, agreement or other arrangement, whether written or otherwise.

(3) action in concert with a person or company which shall also be deemed to be action in concert with any person or company that is acting in concert with such other person or company.

(d) "Affiliate" means any person or company which controls, is controlled by or is under common control with a person, insured institution or company.

(e) "Company" means any corporation, partnership, trust, association, joint venture, pool, syndicate, unincorporated organization, joint-stock company or similar organization, as defined in paragraph (*l*); but a company does not include:

(1) The Federal Savings and Loan Insurance Corporation, or

(2) any company the majority of shares of which is owned by: (i) The United States or any State, (ii) an officer of the United States or any State in his official capacity, or (iii) an instrumentality of the United States or any State.

(f) "Controlling shareholder" means any person who directly or indirectly or acting in concert with one or more persons or companies, or together with members of his immediate family, owns, controls, or holds with power to vote 10 percent or more of the voting stock of a company or controls in any manner the election or appointment of a majority of the company's board of directors.

(g) "Immediate family" means a person's spouse, father, mother, children, brothers, sisters and grandchildren; the father, mother, brothers, and sisters of the person's spouse; and the spouse of the person's child, brother or sister.

(h) "Insured institution" means a Federal association, Federal savings bank, interim Federal association, building and loan, savings and loan, or homestead association or a cooperative bank, or an interim state savings and loan association, the accounts of which are insured by the Corporation; any Federal association or Federal savings bank the deposits of which are insured by the Federal Deposit Insurance Corporation, an institution that retains insurance of accounts by the Corporation pursuant to § 563.29-1 of this chapter, and any savings and loan holding company as defined in paragraph (k) of this section.

(i) "Management official" means any president, chief executive officer, chief operating officer, vice president, director, partner, or trustee, or any other person who performs or has a representative or nominee performing similar policymaking functions, including executive officers of principal business units or divisions or subsidiaries who perform policymaking functions, for an insured institution or a company, whether or not incorporated.

(j) "Person" means an individual or a group of individuals acting in concert who do not constitute a "company" as defined in paragraph (e) of this section.

(k) "Savings and loan holding company" means any company that directly or indirectly controls an insured institution, but does not include:

(1) Any company by virtue of its ownership or control of voting stock of an insured institution acquired in connection with the underwriting of securities if such stock is held only for such period of time (not exceeding 120 days unless extended by the Corporation) as will permit the sale thereof on a reasonable basis, and

(2) Any trust (other than a pension, profit-sharing, stockholders' voting or business trust) which controls an insured institution if such trust by its terms must terminate within 25 years or not later than 21 years and 10 months after the death of individuals living on the effective date of the trust, and: (i) Was in existence and in control of an insured institution on June 26, 1967, or (ii) is a testamentary trust.

(*l*) "Similar organization" for purposes of paragraph (e) of this section means a combination of parties with the potential for or practical likelihood of continuing rather than temporary existence, where the parties thereto have knowingly and voluntarily associated for a common purpose pursuant to identifiable and binding relationships which govern the parties with respect to either:

(1) The transferability and voting of any stock or other indicia of participation in another entity, or

(2) Achievement of a common or shared objective, such as to manage or control another entity.

(m) "Stock" means common or preferred stock.

(n) (1) "Voting stock" means common or preferred stock, general or limited partnership shares or interests, or similar interests if the shares or interests, by statute, charter or in any manner, entitle the holder:

(i) To vote for or to select directors, trustees, or partners (or persons exercising similar functions of the issuing insured institution or company),

(ii) To vote or to direct the conduct of the operations or other significant policies of the issuer.

(2) Notwithstanding anything in paragraph (n)(1) of this section, preferred stock, limited partnership shares or interests, or similar interests are not "voting stock" if: (i) Voting rights associated with the stock, shares or interests are limited solely to the type customarily provided by statute with regard to matters that would significantly and adversely affect the rights or preference of the stock, security or other interest, such as the issuance of additional amounts or classes of senior securities, the modification of the terms of the stock, security or interest, the dissolution of the issuer, or the payment of dividends by the issuer when preferred dividends are in arrears; (ii) the stock, shares or interests represent an essentially passive investment or financing device and do not otherwise provide the holder with control over the issuer; and (iii) the stock, shares or interests do not at the time entitle the holder, by statute, charter, or otherwise, to select or to vote for the selection of directors, trustees, or partners (or persons exercising similar functions) of the issuer.

(3) Notwithstanding anything in paragraph (n) (1) and (2) of this section, "voting stock" shall be deemed to include stock and other securities that, upon transfer or otherwise, are convertible into voting stock or exercisable to acquire voting stock where the holder of the stock, convertible security or right to acquire voting stock has the preponderant economic risk in the underlying voting stock. Securities immediately convertible into voting stock at the option of the holder without payment of additional consideration shall be deemed to constitute the voting stock into which they are convertible; other convertible securities and rights to acquire voting stock shall not be deemed to vest the holder with the preponderant economic risk in the underlying voting stock if the holder has paid less than 50 percent of the consideration required to directly acquire the voting stock and has no other economic interest in the underlying voting stock. For purposes of calculating the percentage of voting stock held by a particular acquiror, stock or other securities convertible into voting stock or exercisable to acquire voting stock which are deemed voting stock under this paragraph (n)(3) shall be included in calculating the amount of voting stock held by the acquiror and the total amount of stock outstanding only to the extent of the voting stock obtainable by such acquiror by such conversion or exercise of rights.

§ 574.3 Acquisition of control of insured institutions.

(a) *Acquisition by a company.* Unless a transaction is exempt under paragraph (c) of this section, or exempt from prior approval under paragraph (d) of this section, no company shall acquire control, as defined in § 574.4 (a) and (b) of this Part, of an insured institution except upon receipt of the written approval of the Corporation or its designee.

(b) *Acquisition by a person.* Unless a transaction is exempt under paragraph (c) of this section, or exempt from prior notice under paragraph (d) of this section, no person shall acquire control, as defined in § 574.4 (a) and (b) of this Part, of an insured institution until written notice has been provided to the Corporation and (1) the Corporation indicates in writing its intent not to disapprove the proposed acquisition or (2) 60 days (or such period of time as the Corporation may specify if the review period has been extended under § 574.6(c)(3) of this Part) have passed since receipt of a notice deemed sufficient under § 574.6(c)(2).

(c) *Exempt transactions.*

(1) The following transactions are exempt from the application requirements of paragraph (a) of this section:

(i) Control of an insured institution acquired by devise under the terms of a will creating a trust which is excluded from the definition of savings and loan holding company under § 574.2(k) of this Part;

(ii) Control of an insured institution acquired in connection with a reorganization which involves solely the acquisition of control of that institution by a newly formed company which is controlled by the same acquirors that controlled the insured institution for the immediately preceding three years, and entails no other transactions, such as an assumption of the acquirors' debt by the newly formed company: *Provided*, that the acquirors have filed an H-(e)4 notification as provided in § 574.6 of this Part and the General Counsel or his delegate does not object to the acquisition within 30 days of the filing date;

(iii) Control of an insured institution acquired solely as a result of (A) a pledge or hypothecation of stock to secure a loan contracted for in good faith or (B) the liquidation of a loan contracted for in good faith, in either case where such loan was made in the ordinary course of the business of the lender: *Provided*, that acquisition of control pursuant to such pledge, hypothecation or liquidation is reported to the Corporation within 30 days, and *Provided further*, that the acquiror shall not retain such control for more than one year from the date on which such control was acquired; however, the Corporation may, upon application by an acquiror, extend such one-year period from year to year, for an additional period of time not exceeding three years, if the Corporation finds such extension is warranted and would not be detrimental to the public interest;

(iv) Control of an insured institution acquired through a percentage increase in stock ownership following a *pro rata* stock dividend or stock split, if the proportional interests of the recipients remain substantially the same;

(v) Acquisition of additional stock after approval under § 574.7 of this Part, or any predecessor provision, has been received, *Provided* that such acquisition is consistent with any conditions imposed in connection with such approval and with the representations made by the acquiror in its application.

(2) The following transactions are exempt from the notice requirements of paragraph (b) of this section:

(i) Transactions which are exempt pursuant to paragraph (c)(1) (iii), (iv) and (v) of this section;

(ii) Transactions for which approval is required under paragraph (a) of this section;

(iii) Transactions for which approval is required under §§ 546, 552.13 or 563.22 of this Chapter: *Provided*, that no acquiror who currently does not control an insured institution would acquire control of any insured institution as a result of such transaction;

(iv) Acquisition of additional stock of an insured institution by any person who:

(A) Has held power to vote 25 percent or more of any class of voting stock in such institution continuously since March 9, 1979;

(B) Has maintained control of the insured institution continuously since acquiring control in compliance with the Control Act and the Corporation's regulations thereunder then in effect: *Provided*, that such acquisition is consistent with any conditions imposed in connection with such acquisition of control and with the representations made by the acquiror in its notice.

(3) An acquiror that would be considered to be in control of an insured institution pursuant to § 574.4 of this Part on December 26, 1985, shall not be subject to this § 574.3 unless the acquiror acquires additional stock of the insured institution or obtains a control factor with respect to such institution after December 26, 1985, *Provided*, that an acquiror shall not be deemed to have acquired control of an insured institution on the basis of actions taken prior to December 26, 1985, or on the basis of actions taken after December 26, 1985, if such actions are pursuant to and consistent with a materially complete application under the Holding Company Act or notice under the Control Act filed prior to December 26, 1985, if such acquisition is made pursuant to an application approved under the Holding Company Act or a notice under the Control Act that was not disapproved.

(d) *Transactions exempt from prior approval or notice.*

(1) Subject to the conditions set forth in paragraph (d)(2) of this section, the following transactions are exempt from prior approval and prior notice under § 574.3: *Provided*, that the timing of the transaction was not within the control of the acquiror.

(i) Control of an insured institution acquired through *bona fide* gift;

(ii) Control of an insured institution acquired through liquidation of a loan contracted in good faith where the loan was not made in the ordinary course of business of the lender;

(iii) Control of an insured institution acquired through a percentage increase in ownership following a stock split or redemption that was not *pro rata;*

(iv) Control determined pursuant to § 574.4 (a) or (b) as a result of actions by third parties that are not within the control of the acquiror;

(v) Control of an insured institution acquired through testate or intestate succession, *Provided*, that the acquiror transmits written notification of the acquisition to the Corporation within 60 days of the acquisition and provides such additional information as the Corporation may specifically request.

(2) The exemptions provided by paragraphs (d)(1)(i) through (d)(1)(iv) of this section are subject to the following conditions:

(i) The acquiror shall file an application, notice or rebuttal, as appropriate, with the Corporation within 90 days of acquisition of control;

(ii) The acquiror shall not take any action to direct the management or policies of the insured institution or which are designed to effect a change in the business plan of the insured institution other than voting on matters that may be presented to stockholders by management of the insured institution until the Corporation has acted favorably upon the acquiror's application or notice, and the Corporation may require that the acquiror take such steps as the Corporation deems necessary to insure that control is not exercised; and

(iii) If the Corporation disapproves the acquiror's application or notice, the acquiror shall divest such portion of the stock held by the acquiror so as to cause the acquiror not to be determined to be in control of the insured institution under § 574.4 of this Part, within one year or such shorter period of time and in the manner that the Corporation may order.

(e) *Prohibited acquisitions.* No acquisition shall be approved by the Corporation, other than an acquisition authorized pursuant to 12 U.S.C. § 1730a(m) or specific order of the Board in a supervisory case, which would:

(1) Result in the formation by any company, through one or more subsidiaries or through one or more transactions, of a multiple savings and loan holding company controlling insured institutions in more than one state where the acquisition causes an insured institution to become an affiliate of another insured institution with which it was not previously affiliated;

(2) Enable an existing multiple savings and loan holding company to acquire an insured institution the principal office of which is located in a State other than the State which such savings and loan holding company has designated pursuant to paragraph (e) of § 584.1 of this Chapter.

§ 574.4 Control.

(a) *Conclusive control.*

(1) An acquiror shall be deemed to have acquired control of an insured institution, other than a savings and loan holding company, if the acquiror directly or indirectly, through one or more subsidiaries or transactions or acting in concert with one or more persons or companies:

(i) Acquires more than 25 percent of any class of voting stock of the insured institution;

(ii) Acquires irrevocable proxies representing more than 25 percent of any class of voting stock of the insured institution;

(iii) Acquires any combination of voting stock and irrevocable proxies representing more than 25 percent of any class of voting stock of an insured institution; or

(iv) Controls in any manner the election of a majority of the directors of the insured institution.

(2) An acquiror shall be deemed to have acquired control of a company, including a savings and loan holding company, if the acquiror directly or indirectly, or through one or more subsidiaries or transactions or acting in concert with one or more persons or companies:

(i) Acquires more than 25 percent of any class of voting stock of the company;

(ii) Acquires irrevocable proxies representing more than 25 percent of any class of voting stock of the company;

(iii) Acquires any combination of voting stock and irrevocable proxies representing more than 25 percent of any class of voting stock of an insured institution;

(iv) Controls in any manner the election of a majority of the directors or trustees of a company;

(v) Is a general partner of a company;

(vi) Has contributed more than 25 percent of the capital of the company; or

(vii) Is a trustee of a trust.

(3) A company shall be deemed to control an insured institution if the Corporation finds, after notice and opportunity for hearing, that the company has the power directly or indirectly, to exercise a controlling influence over the management or policies of the insured institution.

(4) A person shall be deemed to control an insured institution if the Corporation determines that such person has the power to direct the management or policies of the insured institution.

(b) *Rebuttable control determinations.*

(1) An acquiror shall be determined, subject to rebuttal, to have acquired control of an insured institution, if the acquiror directly or indirectly, or through one or more subsidiaries or transactions or acting in concert with one or more persons or companies:

(i) Acquires more than 10 percent of any class of voting stock of the insured institution and is subject to any control factor, as defined in paragraph (c) of this section;

(ii) Acquires more than 25 percent of any class of stock of the insured institution and is subject to any control factor, as defined in paragraph (c) of this section.

(2) An acquiror shall be determined, subject to rebuttal, to have acquired control of an insured institution, if the acquiror directly or indirectly, or through one or more subsidiaries or transactions or acting in concert with one or more persons or companies, holds any combination of voting stock and revocable and/or irrevocable proxies, representing more than 25 percent of any class of voting stock of an insured institution, excluding such proxies held in connection with a solicitation by, or in opposition to, a solicitation on behalf of management of the insured institution, but including a solicitation in connection with an election of directors, and such proxies would enable the acquiror to:

(i) Elect one-third or more of the insured institution's board of directors, including nominees or representatives of the acquiror currently serving on such board;

(ii) Cause the insured institution's stockholders to approve the acquisition or corporate reorganization of the insured institution; or

(iii) Exert a continuing influence on a material aspect of the business operations of the insured institution.

(c) *Control factors.* For purposes of paragraph (b)(1) of this section, the following constitute control factors. References to the acquiror include actions taken directly or indirectly, or through one or more subsidiaries or transactions or acting in concert with one or more persons or companies:

(1) The acquiror would be one of the two largest holders of any class of voting stock of the insured institution.

(2) The acquiror would hold more than 25 percent of the total stockholders' equity of the insured institution.

(3) The acquiror would hold more than 35 percent of the combined debt securities and stockholders' equity of the insured institution.

(4) The acquiror is party to any agreement (i) pursuant to which the acquiror possesses a material economic stake in the insured institution resulting from a profit-sharing arrangement, use of common names, facilities or personnel, or the provision of essential services to the insured institution, or (ii) that enables the acquiror to influence a material aspect of the management or policies of the insured institution, other than agreements to which the insured institution is a party where the restrictions are customary under the circumstances and in the case of an acquisition agreement, which apply only during the period when the acquiror is seeking Corporation approval to acquire the insured institution, the agreement prohibits transactions between the acquiror and the insured institution and their respective affiliates without Supervisory Agent approval during the pendency of the application process, and the agreement contains no material forfeiture provisions applicable to the insured institution in the event the acquisition is not approved or not approved by a specified date.

(5) The acquiror would have the ability, other than through the holding of revocable proxies, to direct the votes of more than 25 percent of a class of the insured institution's voting stock or to vote more than 25 percent of a class of the insured institution's voting stock in

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the future upon the occurrence of a future event.

(6) The acquiror would have the power to direct the disposition of more than 25 percent of a class of the insured institution's voting stock in a manner other than a widely dispersed or public offering.

(7) The acquiror and/or the acquiror's representatives or nominees would constitute more than one member of the insured institution's board of directors.

(8) The acquiror or a nominee or management official of the acquiror would serve as the chairman of the board of directors, chairman of the executive committee, chief executive officer, chief operating officer, chief financial officer or in any position with similar policymaking authority in the insured institution.

(d) *Rebuttable presumptions of concerted action.* An acquiror will be presumed to be acting in concert with the following persons and companies:

(1) A company will be presumed to be acting in concert with a controlling shareholder, partner, trustee or management official of such company with respect to the acquisition of stock of an insured institution, if

(i) Both the company and the person own stock in the insured institution,

(ii) The company provides credit to the person to purchase the insured institution's stock, or

(iii) The company pledges its assets or otherwise is instrumental in obtaining financing for the person to acquire stock of the insured institution;

(2) A person will be presumed to be acting in concert with members of the person's immediate family;

(3) Persons will be presumed to be acting in concert with each other where (i) both own stock in an insured institution and both are also management officials, controlling shareholders, partners, or trustees of another company, or (ii) one person provides credit to another person or is instrumental in obtaining financing for another person to purchase stock of the insured institution;

(4) A company controlling or controlled by another company and companies under common control will be presumed to be acting in concert;

(5) Persons or companies will be presumed to be acting in concert where they constitute a group under the beneficial ownership reporting rules under section 13 or the proxy rules under section 14 of the Securities Exchange Act of 1934, promulgated by the Securities and Exchange Commission;

(6) A person or company will be presumed to be acting in concert with any trust for which such person or company serves as trustee;

(7) Persons or companies will be presumed to be acting in concert with each other and with any other person or company with which they also are presumed to act in concert.

(e) *Procedures for rebuttal.*—(1) *Rebuttal of control determination.* An acquiror attempting to rebut a determination of control that would arise under paragraph (b) of this section shall file a submission with the Corporation setting forth the facts and circumstances which support the acquiror's contention that no control relationship would exist if the acquiror acquires stock or obtains a control factor with respect to an insured institution. The rebuttal must be filed and accepted in accordance with this section before the acquiror acquires such stock or control factor.

(i) An acquiror seeking to rebut the determination of control arising under paragraph (b)(1) of this section shall submit to the Corporation an agreement setting forth the undertakings specified in paragraphs (e)(1)(i) (A) through (F) of this section. Unless agreed to by the Corporation or its delegate in writing, no undertaking shall be deemed to rebut the determination of control arising under paragraph (b)(1) of this section. In the case of a rebuttal of a presumption of control arising under paragraph (b)(1), such agreement shall be in form and content satisfactory to the Corporation, executed by the acquiror and to be executed on behalf of the Corporation, and shall specifically state that violation of the terms of the agreement shall be subject to such penalties, remedies and procedures as are provided for violations, willful or otherwise, of agreements with the Corporation and violations of the Holding Company Act or the Control Act, as applicable, and undertake that the acquiror and its nominees and affiliates will not:

(A) Seek or accept representation of more than one member on the insured institution's board of directors;

(B) Have or seek to have any representative serve as the chairman of the board of directors, or chairman of an executive or similar committee of the insured institution's board of directors, or as president or chief executive officer of the insured institution;

(C) Engage in any inter-company transactions with the insured institution or its affiliates;

(D) Propose directors in opposition to nominees proposed by management for the insured institution's board of directors other than as permitted in paragraph (A) above;

(E) Solicit proxies or participate in any solicitation of proxies with respect to any matter presented to the insured institution's stockholders other than in support of, or in opposition to, a solicitation conducted on behalf of management of the institution;

(F) Do any of the following, except as necessary solely in connection with performance of duties as a member of the insured institution's board of directors:

(*1*) Influence or attempt to influence in any respect the loan or the credit decisions or policies of the insured institution, the pricing of services, any personnel decisions, the location of any offices, branching, or similar activities of the insured institution;

(*2*) Influence or attempt to influence the insured institution's dividend policies and practices or any decisions or policies of the insured institution as to the issuance, offering or exchange of any securities;

(*3*) Seek to amend, or otherwise take action to change, the insured institution's bylaws, articles of incorporation, or charter;

(*4*) Exercise, or attempt to exercise, directly or indirectly, control or a controlling influence over the insured institution's management policies or business operations; or

(*5*) Seek or accept access to any non-public information concerning the insured institution.

(ii) An acquiror seeking to rebut the determination of control with respect to holding of proxies arising under paragraph (b)(2) of this section shall be subject to the requirements of paragraph (e)(1) of this section, except that in the case of a rebuttal of the presumption of control arising under paragraph (b)(2) of this section, the Corporation may require the acquiror to furnish information in response to a specific request for information and depending upon the particular facts and circumstances, to provide a rebuttal agreement containing the undertakings specified in paragraph (e)(1)(i) of this section, with any modifications to paragraphs (e)(1)(i) (A) through (F) deemed necessary by the Corporation or its delegate.

(2) *Presumptions of concerted action.* An acquiror attempting to rebut the presumption of concerted action arising under paragraph (d) of this section shall file a submission with the Corporation setting forth facts and circumstances which clearly and convincingly demonstrate the acquiror's contention that no action in concert exists. Such a statement must be accompanied by an affidavit, in form and content

satisfactory to the Corporation executed by each person or company presumed to be acting in concert, stating that such person or company does not and shall not, without having made necessary filings and obtained approval or clearance thereof under the Savings and Loan Holding Company Act or the Change in Savings and Loan Control Act, as applicable, have any agreements or understandings, written or tacit, with respect to the exercise of control, directly or indirectly, over the management or policies of the insured institution, including agreements relating to voting, acquisition or disposition of the insured institution's stock. The affidavit shall also recite that the signatory is aware that the filing of a false affidavit may subject the person or company to criminal sanctions, would constitute a violation of the Corporation's regulations at 12 CFR 563.18(b), and would be considered a "presumptive disqualifier" under 12 CFR 574.7(g)(1)(v).

(3) *Determination.* Within 20 calendar days of the date of filing of a complete rebuttal submission, the Office of Examinations and Supervision, with the concurrence of the Office of General Counsel, will provide notification of its determination to accept the submission: *Provided,* that the acquiror has sought to rebut the determination of control through the undertakings specified in this section. If such 20-day period has elapsed without a determination not to accept the submission, the rebuttal submission shall be deemed to be accepted. The Corporation and its delegates are not required to accept any rebuttal which is inconsistent with facts and circumstances known to them, or where the rebuttal does not clearly and convincingly refute the presumption of action in concert, and may determine not to accept a submission solely on such bases.

(f) *Safe harbor.* Notwithstanding any other provision of this section, where an acquiror has no intention to participate in or to seek to exercise control over an insured institution's management or policies, the acquiror may seek to qualify for a safe harbor with respect to its ownership of stock of an insured institution.

(1) In order to qualify for the safe harbor, an acquiror must submit a certification, which shall be signed by the acquiror or an authorized representative thereof and shall read as follows:

The undersigned makes this submission pursuant to § 574.4(f) of the regulations of the Federal Home Loan Bank Board ("Board") with respect to [name of insured institution] and hereby certifies to the Board the following:

The undersigned is not in control of [name of insured institution] under § 574.4(a).

The undersigned is not subject to any control factor as enumerated in § 574.4(c) with respect to the [name of insured institution].

The undersigned will not solicit proxies relating to the voting stock of [name of insured institution].

Before any change in status occurs that would bring the undersigned within the scope of § 574.4 (a) or (b), the undersigned will file and obtain approval of a rebuttal, notice or application, as appropriate.

The undersigned has not acquired stock of [name of insured institution] for the purpose or effect of changing or influencing the control of [name of insured institution] or in connection with or as a participant in any transaction having such purpose or effect.

(2) An acquiror claiming safe-harbor status may vote freely and dissent with respect to its own stock. Certifications provided for in this paragraph shall be submitted to the Corporation in accordance with § 574.6(b)(6) of this Part.

§ 574.5 Certifications of ownership and other reports.

(a) *Acquisition of stock.*

(1) Upon the acquisition of beneficial ownership which exceeds, in the aggregate, 10 percent or more of any class stock of an insured institution or additional stock above 10 percent of the stock of an insured institution occurring after December 26, 1985, an acquiror shall file in accordance with § 574.6(b)(7) of this Part a certification with the Corporation as described in this section.

(2) The certification filed pursuant to this section shall be signed by the acquiror or an authorized representative thereof and shall read as follows:

"The undersigned is the beneficial owner of 10 percent or more of a class of stock of [name of insured institution or holding company]. The undersigned is not in control of such institution, as defined in 12 CFR § 574.4(a), and is not subject to a rebuttable determination of control under § 574.4(b), and will take no action that would result in a determination of control or a rebuttable determination of control without first filing and obtaining approval of an application under the Savings and Loan Holding Company Act or notice under the Change in Savings and Loan Control Act or filing and obtaining acceptance by the Corporation of a rebuttal of the rebuttable determination of control."

(3) Notwithstanding anything contained in this paragraph (a), an acquiror is not required to file a certification if (i) the Board has approved the acquisition of the insured institution or (ii) the acquiror has filed a materially complete application or notice pursuant to § 574.3 of this Part.

(b) *Reports of loans secured by voting stock.* Whenever an insured institution or a bank which has accounts insured by the Federal Deposit Insurance Corporation makes a loan or loans secured (or to be secured) by 25 percent or more of the outstanding voting stock of an insured institution, unless the borrower has been the owner of record of such stock for a period of one year or more, or the stock is of a newly organized institution prior to its opening, a report shall be filed with the Corporation by the president or other chief executive officer of the lending institution containing the following information:

(1) The name of the borrower;

(2) The date and amount of the loan;

(3) The name of the insured institution which has issued or is to issue the stock securing the loan; and

(4) The number of shares securing the loan.

(c) *Privacy.* All reports and certifications filed under this § 574.5 shall be for the information of the Corporation in connection with its examination functions and shall be provided confidential treatment by the Corporation.

§ 574.6 Procedural requirements.

(a) *Form of application or notice.* An application or notice required by § 574.3 of this Part shall be filed in the form prescribed by the Corporation as provided in this section. An acquiror may request confidential treatment of portions of an application or notice only by complying with the requirements of § 574.6(f) of this Part.

(1) *H-(e)1.* This application shall be used for all applications filed under § 574.3(a) by a company, other than a savings and loan holding company, for approval of an acquisition of one insured institution.

(2) *H-(e)2.* This application shall be used for all applications filed under § 574.3(a) for approval of acquisitions of (i) one or more insured institutions by a savings and loan holding company or (ii) more than one insured institution by any other company.

(3) *H-(e)3.* This application shall be used for all applications filed under § 574.3(a): (i) by a savings and loan holding company for approval of acquisitions by a merger, consolidation, or purchase of assets of an insured or uninsured institution or a savings and loan holding company, or (ii) by any company for approval of acquisitions by a merger, consolidation, or purchase of assets of two or more insured

institutions, and shall be used also for approval under §§ 563.22 and 571.5 of this Chapter.

(4) *H-(e)4.* This information filing shall be used to claim that a reorganization is exempt from prior written approval of the Corporation under § 574.3(c)(1)(ii).

(5) *Notice Form 1173, Parts A and B.* This form shall be used for all notices filed under § 574.3(b) regarding the acquisition of control of an insured institution by any person or persons not constituting a company.

(b) *Filing requirements.*—(1) *Applications.* Any application required or provided for by a company shall be filed with the Corporation as follows: Where an application is not eligible to be processed under delegated authority under § 574.8(a), the company shall transmit three complete copies including exhibits and other pertinent papers and documents to the Office of the Secretariat, Federal Home Loan Bank Board, Washington, D.C. 20552, with one copy indicated "Attention: Secretariat, Records Copy," a second copy indicated "Attention: Office of Examinations and Supervision," and a third copy indicated "Attention: Office of General Counsel, Corporate and Securities Division," and shall transmit a fourth complete copy including exhibits and other pertinent papers and documents to the Principal Supervisory Agent of the district in which the insured institution or institutions involved in the acquisitions have their home offices. At least one copy of the application filed with each noted office shall be manually signed. Unsigned copies shall be conformed. Where a company believes its application is eligible to be processed under delegated authority under § 574.8(a), the company shall file only two copies with the Secretariat, with one copy indicated "Attention: Secretariat, Records Copy," and a second copy indicated "Attention: Office of Examinations and Supervision," and shall transmit two copies with the Principal Supervisory Agent and shall also transmit, together with all copies of its application, a brief summary of the proposed transaction including a statement as to why the company asserts the application may be processed under delegated authority, including an affirmative statement that none of the factors specified in § 574.8(a)(1) which would preclude action under delegated authority are present. Such statement shall be clearly labeled "Statement Regarding Eligibility for Processing Under Delegated Authority." If the company subsequently becomes aware of additional information or changed circumstances which would alter the eligibility of the application for processing under delegated authority, the company shall promptly so advise the Principal Supervisory Agent in writing. An applicant shall also comply with section 7A of the Clayton Act (15 U.S.C. 18A) and regulations issued thereunder (Parts 801, 802, and 803 of title 16 of the Code of Federal Regulations).

(2) *H-(e)4 Information filing.* Any information filing required to be made to claim that a reorganization is exempt from prior written approval of the Corporation under § 574.3(c)(1)(ii) shall be filed with the Office of the Secretariat, Federal Home Loan Bank Board, Washington, D.C. 20552, with one copy indicated "Attention: Secretariat, Records Copy," a second copy indicated "Attention: Office of General Counsel, Corporate and Securities Division, and a third copy filed with the appropriate Principal Supervisory Agent for the institution to be acquired. Such a filing shall be clearly labeled "H-(e)4 Information Filing."

(3) *Notice.* Any notice required to be filed by a person or persons shall be filed with the Corporation as follows: Where a notice is not eligible to be processed under delegated authority pursuant to § 574.8(a), the person shall transmit three complete copies of the notice, including exhibits and other pertinent papers and documents, to be filed with the Office of the Secretariat, Federal Home Loan Bank Board, Washington, D.C. 20552, with one copy indicated "Attention: Secretariat, Records Copy," a second copy indicated "Attention: Office of Examinations and Supervision," and a third copy indicated "Attention: Office of General Counsel, Corporate and Securities Division," and shall transmit a fourth complete copy of the application and exhibits filed with the appropriate Principal Supervisory Agent.

At least one copy of the notice filed with each noted office shall be manually signed. Where a person believes his notice is eligible to be processed under delegated authority under § 574.8(a), the person shall file only two copies with the Secretariat, with one copy indicated "Attention: Secretariat, Records Copy," and a second copy indicated "Attention: Office of Examinations and Supervision," and shall transmit two copies to the Principal Supervisory Agent and shall also transmit, together with all copies of his notice, a brief summary of the proposed transaction including a statement as to why the person asserts the notice may be processed under delegated authority, including an affirmative statement that none of the factors specified in § 574.8(a)(1) which would preclude action under delegated authority are present. Such statement shall be clearly labelled "Statement Regarding Eligibility for Processing Under Delegated Authority." If the person subsequently becomes aware of additional information or changed circumstances which would alter the eligibility of the notice for processing under delegated authority, the person shall promptly so advise the Principal Supervisory Agent in writing. In addition, in the case of a notice not delegated to the Principal Supervisory Agent under § 574.8(a), an acquiror filing a notice of the acquisition of a state-chartered institution shall file an additional copy with the Office of Secretariat indicated "Attention: Office of Examinations and Supervision/State Supervisor Copy." Where such a notice may be processed under delegated authority under § 574.8(a), the extra copy shall be filed with the Principal Supervisory Agent, indicated "State Supervisor Copy."

(4) *Amendment.* Any acquiror may amend an application or notice or file additional supporting information upon request of the Supervisory Agent or the Corporation or upon its own initiative.

(5) *Rebuttal filing.* In order to apply to rebut a determination or presumption pursuant to § 574.4(e) of this Part, three copies, one of which shall be manually signed, shall be submitted to the Office of the Secretariat, Federal Home Loan Bank Board, Washington, DC 20552, with one copy indicated "Attention: Secretariat, Records Copy," a second copy indicated "Attention: Office of Examinations and Supervision," and a third copy indicated "Attention: Office of General Counsel, Corporate and Securities Division," and one copy shall be transmitted to the appropriate Principal Supervisory Agent.

(6) *Safe-harbor filing.* In order to qualify for the safe harbor under § 574.4(f), a certification must be filed setting forth the information required by § 574.4(f). Three copies, one of which shall be manually signed, shall be submitted to the Office of the Secretariat, Federal Home Loan Bank Board, Washington, DC 20552, with one copy indicated "Attention: Secretariat, Records Copy," a second copy indicated "Attention: Office of General Counsel, Corporate and Securities Division" and a third copy indicated "Attention: Office of Examinations and Supervision", and one copy shall be transmitted to the appropriate Principal Supervisory Agent.

(7) *Certification.* Certifications required by § 574.5(a) shall be filed in the same manner as a safe harbor filing under paragraph (b)(6) of this section.

(8) *Reports of loans.* Reports of loans required by § 574.5(b) shall be filed in the same manner as a safe harbor filing under paragraph (b)(6) of this section.

(9) *Reports on pledges, hypothecations and liquidations.* Reports of pledges, hypothecations and liquidation transactions required by § 574.3(c)(1)(iii) shall be filed in the same manner as a safe harbor filing under paragraph (b)(6) of this section.

(c) *Sufficiency and waiver.*

(1) An application or notice filed pursuant to §§ 574.3(a) or 574.3(b) shall not be deemed sufficient unless it includes all of the information required by the form prescribed by the Corporation and this Part, including a complete description of the acquiror's proposed plan for acquisition of control whether pursuant to one or more transactions, and any additional relevant information as the Corporation may require by written request to the applicant. Unless an application or notice specifically indicates otherwise, the application or notice shall be considered to pertain to acquisition of 100 percent of an insured institution's voting stock. Where an application or notice pertains to a lesser amount of stock, the Corporation may condition its approval or non-disapproval to apply only to such amount, in which case additional acquisitions may be made only by amendment to the acquiror's application or notice and Corporation approval or non-disapproval thereof. Failure by an applicant to respond completely to a written request by the Corporation or its delegate for additional information within 30 calendar days of the date of such request may be deemed to constitute withdrawal of the application or notice, or may be treated as grounds for denial of an application or issuance of a notice of disapproval of a notice.

(2) The period for Corporation review of any proposed acquisition will commence upon receipt by the Corporation of a notice or application deemed sufficient under paragraph (c)(1) of this section. The Corporation shall notify an acquiror within 10 business days after the close of the public comment period specified in paragraph (e) of this section as to whether an application or notice is deemed sufficient. The Corporation also shall notify an acquiror within 10 business days after the timely filing of any additional information furnished in response to a specific request by the Corporation as to whether the application or notice is thereby deemed to be sufficient. If the Corporation fails to notify an acquiror within such times, the application or notice shall be deemed to be sufficient as of the expiration of such 10 day period, except that where an acquiror requests a waiver of required information, the application or notice shall not be deemed to be sufficient until the waiver is granted.

(3) After additional information has been requested and supplied, the Corporation may request additional information only with respect to matters derived from or prompted by information already furnished, or information of a material nature that was not reasonably available from the acquiror, was concealed, or pertains to developments subsequent to the time of the Corporation's initial request for additional information. With regard to information of a material nature that was not reasonably available from the acquiror or was concealed at the time a notice was deemed to be sufficient or which pertains to developments subsequent to the time a notice was deemed to be sufficient, the Corporation, at its option, may request such additional information as it considers necessary, or may deem the notice not to be sufficient until such additional information is furnished and cause the review period to commence again in its entirety upon receipt of such additional information.

(i) The 60-day period for Corporation review of a notice deemed to be sufficient also may be extended by the Corporation for up to 30 days.

(ii) The period for Corporation review of a notice may be further extended if the Corporation determines that any acquiring party has not furnished all of the information required by the Corporation or any material information submitted is substantially inaccurate.

(iii) In the case of an application or notice that is not eligible for processing under delegated authority by the Principal Supervisory Agent pursuant to § 574.8(a), actions by the PSA or his delegate shall not commence any of the periods described in this paragraph (c) for review.

(4) With respect to an H-(e)4 information filing, the General Counsel shall have 30 days after receipt of a filing deemed sufficient to disapprove the assertion that the company qualifies for the exemption provided in § 574.3(c)(1)(ii). After the expiration of such 30-day period without response from the General Counsel, the filing shall be deemed to be approved.

(5) The Corporation may waive any requirements of this subsection determined to be unnecessary by the Corporation upon the written request of an acquiring person, or in a supervisory case.

(d) *Publication.* (1) An acquiror shall publish a notification as provided in this section within 10 calendar days after filing an application under § 574.3(a) or notice under § 574.3(b), and shall mail a copy of the notification to the institution whose stock is sought to be acquired. Publication shall be made in the business section of a newpaper printed in the English language in: (i) the community in which the home office of the insured institution is located; and (ii) if applicable, the community in which the home office of the largest subsidiary insured institution of the acquiror is located. If it is determined that the primary language of a significant number of adult residents of either community is a language other than English, the acquiror may be required to publish the notification simultaneously in the appropriate language(s).

(2) Notice published pursuant to this paragraph (d) shall be published in a manner that is conspicuous to the average reader and shall be made in substantially the following form:

Notice of Filing of Application or Notice for Acquisition of an Insured Institution

This is to inform the public that under § 574.3 of the Federal Home Loan Bank Board Regulations for Acquisitions of Insured Institutions [*Acquiror*] has filed an [application/notice] with the Federal Savings and Loan Insurance Corporation for permission to acquire control of [insured institution], located in [*location*], on [*date of filing*].

Anyone may write in favor of or protest against the application and in so doing may submit such information as he deems relevant. Copies of all submissions must be sent to the Principal Supervisory Agent, Federal Home Loan Bank of [give name and address] [and in the case of applications or notices not delegated to the Principal Supervisory Agent under § 574.8(a), three copies to the Office of the Secretariat, Federal Home Loan Bank Board, Washington, DC. 20552, with one copy indicated "Attention: Secretariat Records Copy," a second copy indicated "Attention: Office of General Counsel, Corporate and Securities Division" and a third copy indicated "Attention: Office of Examinations and Supervision"] within 20 calendar days of the publication of this notification. An additional 20 calendar days to submit comments may be obtained upon a showing of good cause if a written request is received by the Principal Supervisory Agent within the initial 20-day period.

You may inspect the non-confidential portion of the application/notice and non-confidential portions of all comments filed at the Federal Home Loan Bank of ——— [and in the case of applications and notices not delegated to the Principal Supervisory Agent by contacting the Information Services Section, Office of the Secretariat, Federal Home Loan Bank Board, Washington, DC 20552.] If you have any questions concerning these procedures, contact the Federal Home Loan Bank of ——, at ( ) ——, [and the Information Services Section at (202) 377-——.]

(3) Promptly after publication, the acquiror shall transmit copies of each notice and a publisher's affidavit of publication to the Office of Examinations and Supervision and to the Principal Supervisory Agent of the district in which the insured institutions involved in the acquisition have their home offices. In addition, where an insured institution to be acquired (including a holding company thereof) has securities registered under the Securities Exchange Act of 1934, one copy of the notice also shall be transmitted to the Office of General Counsel, Corporate and Securities Division.

(4) Notice shall be provided to the appropriate state supervisor and to persons whose request for announcements under § 563e.6 of this subchapter have been received in time for such notification; these notices shall be in addition to legal notification as set forth in paragraph (d)(1) of this section. Any other persons who might have an interest in the application or notice may also be notified.

(5) Disclosure of any part of an application or notice shall be made only in compliance with paragraph (f) of this section.

(e) *Public comment.* Comments by the public shall be submitted only as provided in this paragraph or as requested by the Corporation. Within 20 calendar days of the date of publication (or 40 calendar days after such date if an extension is requested in writing within the initial 20-day period), anyone may file comments in favor or in protest of the application or notice, and in so doing may submit such information as be deemed relevant. Comments received after the comment period, unverified accusations, or materials that the submitter is unwilling to have disclosed to the acquiror, shall not be part of the record and shall not be considered by the Corporation. Comments shall be filed in the manner and in the locations provided in paragraph (b) of this section for the application or notice to which the comments pertain.

(f) *Disclosure.* (1) Public disclosure shall be made of any portion of an application or notice, other filing or public comment made under this section for which confidential treatment is not requested in accordance with this paragraph, and shall be made of other portions of an application, notice, other filing or public comment in accordance with paragraph (f)(2) of this section, the provisions of the Freedom of Information Act (5 U.S.C. 552a) and Part 505 and 505a of this Chapter. Applicants and other submitters should provide confidential and non-confidential versions of their filings, as described in § 574.6(f)(2) and (3) in order to facilitate this process.

(2) Any person who submits any information or causes or permits any information to be submitted to the Corporation pursuant to this Part may request that the Corporation afford confidential treatment under the Freedom of Information Act to such information for reasons of personal privacy or business confidentiality, (which shall include such information that would be deemed to result in the commencement of a tender offer under § 240.14d–2 of title 17 of the *Code of Federal Regulations*), or for any other reason permitted by Federal law. Such request for confidentiality must be made and justified in accordance with paragraph (f)(6) at the time of filing, and must, to the extent practicable, identify with specificity the information for which confidential treatment may be available and not merely indicate portions of documents or entire documents in which such information is contained. Failure to specifically identify information for which confidential treatment is requested may be a basis for denial of the request. In addition, the filing party should take all steps reasonably necessary to ensure, as nearly as practicable, that at the time the information is first received by the Corporation (i) it is supplied segregated from information for which confidential treatment is not being requested, (ii) it is appropriately marked as confidential, and (iii) it is accompanied by a written request for confidential treatment which identifies with specificity the information as to which confidential treatment is requested. Any such request must be substantiated in accordance with paragraph (f)(6).

(3) All documents which contain information for which a request for confidential treatment is made or the appropriate segregable portions thereof shall be marked by the person submitting the records with a prominent stamp, typed legend, or other suitable form of notice on each page or segregable portion of each page, stating "Confidential Treatment Requested by [name]." If such marking is impracticable under the circumstances, a cover sheet prominently marked "Confidential Treatment Requested by [name]" should be securely attached to each group of records submitted for which confidential treatment is requested. Each of the records transmitted in this manner should be individually marked with an identifying number and code so that they are separately identifiable.

(4) A determination as to the validity of any request for confidential treatment may be made when request for disclosure of the information under the Freedom of Information Act is received or at any time prior thereto. Five business days notice will be provided to the filing party if the Corporation receives a request for the information under the Freedom of Information Act and determines to disclose material for which confidential treatment has been requested.

(5) Substantiation of a request for confidential treatment shall consist of a statement setting forth, to the extent appropriate or necessary for the determination of the request for confidential treatment, the following information regarding the request:

(i) The reasons, concisely stated and referring to specific exemptive provisions of the Freedom of Information Act, why the information should be withheld from access under the Freedom of Information Act;

(ii) The applicability of any specific statutory or regulatory provisions which govern or may govern the treatment of the information;

(iii) The existence and applicability of any prior determination by the Corporation, other Federal agencies, or a court, concerning confidential treatment of the information;

(iv) The adverse consequences to a business enterprise, financial or otherwise, that would result from disclosure of confidential commercial or financial information, including any adverse effect on the business' competitive position;

(v) The measures taken by the business to protect the confidentiality of the commercial or financial information in question and of similar information, prior to, and after, its submission to the Corporation;

(vi) The ease or difficulty of a competitor's obtaining or compiling the commercial or financial information;

(vii) Whether commercial or financial information was voluntarily submitted to the Corporation, and, if so, whether and how disclosure of the information would tend to impede the availability of similar information to the Corporation;

(viii) The extent, if any, to which portions of the substantiation of the request for confidential treatment should be afforded confidential treatment.

(ix) The amount of time after the consummation of the proposed acquisition for which the information should remain confidential and a justification thereof.

(x) Such additional facts and such legal and other authorities as the requesting person may consider appropriate.

(g) *Supervisory cases.* The provisions of paragraphs (d), (e) and (f) of this section may be waived by the Corporation in connection with a transaction approved by the Corporation for supervisory reasons.

(h) *Notification of State supervisor.* Upon receiving a notice relating to the acquisition of control of a state chartered insured institution, the Corporation shall forward a copy of the notice to the appropriate state savings and loan association supervisory agency, and shall allow 30 days within which the views and recommendations of such State supervisory agency may be submitted. The Corporation shall give due consideration to the views and recommendations of such State agency in determining whether to disapprove any proposed acquisition. Notwithstanding the provisions of this paragraph, if the Corporation determines that it must act immediately upon any notice of a proposed acquisition in order to prevent the probable failure of the institution involved in the proposed acquisition, the Corporation may dispense with the requirement of this paragraph or, if a copy of the notice is forwarded to the State supervisory agency, the Corporation may request that the views and recommendations of such State supervisory agency be submitted immediately in any form or by any means acceptable to the Corporation.

§ 574.7 Determination by the corporation.

(a) *Acquisition by a company.* The Corporation shall approve an application by any company other than a savings and loan holding company to acquire control of one insured institution unless it determines that the criteria set forth in paragraph (c) of this section are not met.

(b) *Acquisition by a savings and loan holding company.* The Corporation shall not approve an acquisition by a savings and loan holding company to acquire control of an insured institution, or by any other company to acquire control of more than one insured institution, except in accordance with paragraph (c) of this section. Before approving any such acquisition, the Corporation or its delegate shall request from the Attorney General and consider any report rendered within 30 days of such request on the competitive factors involved.

(c) *Application criteria.* The Corporation may deny an application by a company to acquire an insured institution if the Corporation finds that the financial and managerial resources and future prospects of the company and institution involved would be detrimental to the institution or the insurance risk of the Corporation, or if the acquiror fails or refuses to furnish information requested by the Corporation or its delegate. In connection with applications filed pursuant to § 574.6(a)(2) and (3) of this Part, the Corporation will also consider the convenience and needs of the community to be served. Moreover, the Corporation shall not approve any proposed acquisition:

(1) Which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the savings and loan business in any part of the United States, or

(2) The effect of which on any section of the country may be substantially to lessen competition, or tend to create a monopoly, or which in any other manner would be in restraint of trade, unless the Corporation finds that the anticompetitive effects of the proposed acquisition are clearly outweighed in the public interest by the probable effect of the acquisition in meeting the convenience and needs of the community to be served.

(d) *Notice criteria.* In making its determination whether to disapprove a notice, the Corporation may disapprove any proposed acquisition, if the Corporation determines that:

(1) The proposed acquisition of control would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the savings and loan business in any part of the United States;

(2) The effect of the proposed acquisition of control in any section of the country may be substantially to lessen competition or to tend to create a monopoly or the proposed acquisition of control would in any other manner be in restraint of trade, and the anticompetitive effects of the proposed acquisition of control are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served;

(3) The financial condition of the acquiring person is such as might jeopardize the financial stability of the institution or prejudice the interests of the depositors of the institution;

(4) The competence, experience, or integrity of the acquiring person or any of the proposed management personnel indicates that it would not be in the interests of the depositors of the institution, the Corporation, or the public to permit such person to control the institution; or

(5) The acquiring person fails or refuses to furnish information requested by the Corporation or its delegate.

(e) *Failure to disapprove a notice.* If, upon expiration of the 60-day review period of any notice deemed to be sufficient filed pursuant to § 574.6(c), or extension thereof, the Corporation has failed to disapprove a proposed acquisition may take place: *Provided,* that it is consummated within one year and in accordance with the terms and representations in the notice and that there is no material change in circumstances prior to the acquisition.

(f) *Disapproval of a notice.* Within three business days after its decision to disapprove a notice, the Corporation or its delegate shall notify the acquiror in writing of the disapproval. Such notification shall include a statement of the grounds therefor and a statement that the acquiror within 20 days of the receipt of such notice of disapproval may, if the disapproval was issued by the Principal Supervisory Agent pursuant to delegated authority, request review of such disapproval by the Corporation pursuant to § 574.8(a)(4), or, if such review is denied, or the disapproval issued by the Corporation may within 10 days of receipt of the notice of disapproval, or notice of the Corporation's decision not to review the denial, request an administrative hearing under paragraph (4) of the Control Act.

(g) *Presumptive disqualifiers.*—(1) *Integrity factors.* The following factors shall give rise to a rebuttable presumption that an acquiror may fail to satisfy the managerial resources and future prospects tests of paragraph (c) of this section or the integrity test of paragraph (d)(4) of this section:

(i) During the 10-year period immediately preceding filing of the application or notice, criminal, civil or administrative judgments, consents or orders, and any indictments, formal investigations, examinations, or civil or administrative proceedings (excluding routine or customary audits, inspections and investigations) that terminated in any agreements, undertakings, consents or orders, issued against, entered into by, or involving the acquiror or affiliates of the acquiror by any federal or state court, any department, agency, or commission of the U.S. Government, any state or municipality, any Federal Home Loan Bank, any self-regulatory trade or professional organization, or any foreign government or governmental entity which involve

(A) Fraud, moral turpitude, dishonesty, breach of trust or fiduciary duties, organized crime or racketeering.

(B) Violation of securities or commodities laws or regulations.

(C) Violation of depository institution laws or regulations.

(D) Violation of housing authority laws or regulations;

(E) Violation of the rules, regulations, codes of conduct or ethics of a self-regulatory trade or professional organization;

(ii) Denial, or withdrawal after receipt of formal or informal notice of an intent to deny, be the acquiror or affiliates of the acquiror, of

(A) Any application relating to the organization of a financial institution, (B) an application to acquire any financial institution or holding company thereof under the Savings and Loan Holding Company Act or the Bank Holding Company Act or otherwise, (C) a notice relating to a change in control of any of the foregoing under the Change in Savings and Loan Control Act or the Change in Bank Control Act, or (D) an application or notice under a state holding company or change in control statute.

(iii) The acquiror or affiliates of the acquiror were placed in receivership or conservatorship during the preceding 10 years or any management official of the acquiror was a management official or director of a company or insured institution which entered receivership or conservatorship, was placed in a management consigment program, or was liquidated during his tenure or within two years thereafter;

(iv) Felony conviction of the acquiror, an affiliate of the acquiror or a management official of the acquiror or an affiliate of the acquiror;

(v) Knowingly making any written or oral statement to the Corporation (or its delegate) in connection with an application, notice or other filing under this Part that is false or misleading with respect to a material fact or omits to state material fact with respect to information furnished or requested in connection with such an application, notice or other filing;

(vi) Acquisition and retention at the time of submission of an application or notice, of stock in the insured institution by the acquiror in violation of § 574.3 or its predecessor sections.

(2) *Financial factors.* The following shall give rise to a rebuttable presumption that an acquiror may fail to satisfy the financial-resources and future prospects tests of paragraph (c) of this section, or the financial condition test of paragraph (d)(3) of this section:

(i) Liability for amounts of debt which, in the opinion of the Corporation, create excessive risks of default and pressure on the insured institution to be acquired;

(ii) Failure to furnish a business plan or furnishing a business plan projecting activities which are inconsistent with economical home financing.

§ 574.8 Delegations of authority.

(a) *Actions by the Principal Supervisory Agent.*—(1) *Approval.* The Principal Supervisory Agent is authorized to grant approval of any application filed under § 574.3(a) of this Part or issue a statement of intent not to disapprove a notice filed under § 574.3(b) of this Part: *Provided,* that the following conditions are met:

(i) Neither the acquiror nor the insured institution to be acquired, or any affiliate of either, is required under the Securities Exchange Act of 1934, 15 U.S.C. 78a–78jj, and Part 563d of this Chapter, to make a filing with the Board under any of the following regulations in connection with the transaction in which the acquisition would occur:

(A) Rule 13e–3, 17 CFR 240.13e–3 (for "going private" transactions);

(B) Rule 13e–4, 17 CFR 240.13e–4 (for tender offers by an issuer for its own stock);

(C) Regulation 14A, 17 CFR 240.14a–1 through 240.14a–101 (for solicitation of proxies);

(D) Regulation 14C, 17 CFR 240.14c–1 through 240.14c–101 (for distribution of information statements in lieu of solicitation of proxies); or

(E) Regulations 14D or 14E, 17 CFR 240.14d–1 through 240.14f–1 (for tender offers);

(ii) The acquisition is not opposed by the institution to be acquired or contested by another prospective acquiror;

(iii) The application or notice does not raise a significant issue of law or policy; and

(iv) Where the acquiror is a company, the company is willing to agree in writing that:

(A) It will ensure that its subsidiary insured institution shall have, at the end of each calendar quarter, net worth at least equal to the amount that may be required pursuant to § 563.13 of this Chapter, and that where necessary, the company will infuse additional equity capital in a form satisfactory to the Supervisory Agent and sufficient to effect compliance with such undertaking: *Provided,* that where a company proposes to acquire less than 50 per cent of the voting stock of an insured institution, such company agrees to the foregoing net worth maintenance undertaking on a *pro rata* basis according to its percentage ownership of the insured institution's voting stock; and

(B) The company will service its debt without receiving dividends from the acquired insured institution subsidiary in excess of 50 percent of the subsidiary's net income per year on a cumulative basis, and will not receive dividends from the insured institution in excess of that amount, unless waived by the Supervisory Agent (*1*) on supervisory grounds, (*2*) in cases where the assets of the institution to be acquired will constitute less than five percent of the assets of the insured subsidiary institution(s) of the acquiring company for acquisitions by savings and loan holding companies that have not agreed to restrict the dividends received from, or guarantee the net worth of, its subsidiary insured institution(s).

(2) *Denial.* The Principal Supervisory Agent is authorized to disapprove any application or notice that he is authorized to approve or for which he is authorized to issue a statement of intent not to disapprove under paragraph (a)(1) of this section. Such disapproval shall be in writing, shall set forth with specificity the basis for the denial or disapproval and shall be furnished promptly to the acquiror.

(3) *Other actions.* For notices filed pursuant to § 574.3(b) of this Part, and applications filed pursuant to § 574.3(a) of this Part, which may be approved under paragraph (a) of this section, the Principal Supervisory Agent may take the following actions:

(i) Any action regarding publication provided for in § 574.6(d) of this Part;

(ii) A determination that an application or notice is sufficient or requiring additional information under § 574.6(c)(1) of this Part;

(iii) Extensions of the review period under § 574.6(c)(3)(i) of this Part for up to 30 days.

(iv) A grant or denial of a request for waiver of certified financial statements for an acquiror's proprietary interests required in connection with notice filed under § 574.3(b) of this Part: *Provided,* that the acquiror providers the following substitute information: (A) A statement supporting the acquiror's contention that production of such certified financial statements is unduly burdensome, (B) tables setting forth (*1*) the acquiror's percent of interest in the insured institution to be acquired, the amount of investment in the insured institution and the investment as a percentage of the acquiror's net worth and (*2*) the amount of each entry as a percentage of the acquiror's total assets, net worth and gross income; (*3*) available unaudited financial statements for each entity for which a waiver has been requested which include at least three years of statements for each entity of operations and interim statements within 90 days of the most recently filed amendment, and 2 years of statements of condition and interim statements within 90 days of the most recently filed amendments; (*4*) a letter from an independent accountant indicating changes that would be required to reconcile the financial statements with ones prepered on a basis that would be consistent with generally accepted accounting principles; and (*5*) the lastest available Federal income tax returns for each entity for the immediately preceding two taxable years.

(v) Notification of the state supervisory agent pursuant to § 574.6(h) of this Part.

(4) *Appeal.* Denial of an application or notice by a Principal Supervisory Agent pursuant to paragraph (a) of this section may be appealed to the Corporation under the following procedures: Within 20 days after notification of the Principal Supervisory Agent's decision as provided herein, the acquiror must notify the Office of the Secretariat of the acquiror's desire to appeal the Principal Supervisory agent's decision. Two copies of such request for review must be submitted to the Office of the Secretariat, Federal Home Loan Bank Board, Washington, D.C. 20552, with one copy indicated "Attention: Director, Office of Examinations and Supervision" and a second copy indicated "Attention: Office of General Counsel, Enforcement Division," with one copy to the appropriate Principal Supervisory Agent. The request for review must identify the party seeking review and describe with specificity the action taken for which review is sought and the reasons why the Principal Supervisory Agent's denial or notice of disapproval is contended to be erroneous. If an applicant does not file an appeal within the time permitted under this section, any objection to the initial determination by the applicant is waived. A timely appeal filed with the Secretariat in accordance with the provisions of this section shall be mandatory for securing judicial review of an initial determination.

(b) *Joint actions by the Director of the Office of Examinations and Supervision and the General Counsel.* The Director of the Office of Examinations and Supervision with the concurrence of the General Counsel or their respective designees are authorized to take the following actions:

(1) Approve any application or issue notice of intent not to disapprove any notice (i) which does not raise a significant issue of law or policy, including approval or issuance of notice of intent not to disapprove applications or notices that are opposed by the insured institution to be acquired or contested by another prospective acquiror, and

(ii) which does not involve net worth maintenance or dividend conditions that fail to conform to paragraph (a)(1)(iv) of this section;

(2) Decide whether a determination of control under § 574.4(b) of this Part or a presumption of acting in concert under § 574.4(d) of this Part has been rebutted;

(3) With regard to notices filed under § 574.3(b) of this Part, to acquire control of insured institutions which cannot be approved under paragraph (a) of this section:

(i) All actions regarding publication required or permitted by § 574.6(d) of this Part;

(ii) Any other action which would otherwise be delegated to the Principal Supervisory Agent pursuant to paragraphs (a) (1) and (3) of this section;

(4) Grant waivers of certified financial statements for an acquiror's proprietary interests in connection with notices filed under § 574.3(b) of this Part which cannot be approved under paragraph (a) of this section.

(5) Notify the state supervisory agent pursuant to § 574.6(b) of this Part.

(c) *Sole authority in the Corporation.* The Corporation alone may:

(1) Approve or deny any applications or determine whether to disapprove notices which are not delegated;

(2) In addition to any other remedies available to the Corporation, assess a civil penalty under paragraph (16) of the Control Act for any person who willfully violates any provision of the Control Act, or any regulation or order issued by the Corporation pursuant thereto, of not more than $10,000 per day for each day during which the violation continues:

(i) By giving written notice of the basis for the violation, the amount of the proposed civil penalty, and an opportunity for the person to submit data, views, and arguments within 20 days; and

(ii) By giving due consideration to the appropriateness of the penalty with respect to each of the factors specified in paragraph (16) of the Control Act, 12 U.S.C. 1730(q)(16), and issuing to the person, within 30 days of the expiration of the period provided to make a submission, a written notice of the Corporation's order of assessment which must be paid within 10 days, unless otherwise agreed to, or the Corporation may bring an action to collect the assessed penalty;

(3) In addition to any other remedies available to the Corporation, assess a civil penalty of up to $1,000 per day for each day during which the violation continues under section 408(j) of the Holding Company Act, 12 U.S.C. 1730a(j), for any company that violates or any person who participates in a violation of the Holding Company Act or any regulation or order issued pursuant thereto. As used in this paragraph, the term "violates" includes, without limitation, any action (alone or with another or others) for or toward causing bringing about, participating in, counseling, or aiding and abetting a violation;

(4) Cause the review period to commence again after a determination of sufficiency has been made under § 574.6(c)(2) of this Part, or extend the review period pursuant to § 574.6(c)(3)(ii) of this Part.

(5) Grant waivers under § 574.6(c)(5).

SUBCHAPTER F—SAVINGS AND LOAN HOLDING COMPANIES

PART 584—REGULATED ACTIVITIES

5. The authority citation for Part 584 continues to read as follows:

Authority: Sec. 408, 82 Stat. 5 (12 U.S.C. 1730a) unless otherwise noted.

6. Revise § 584.4 as follows:

§ 584.4 Prohibited acquisitions.

No savings and loan holding company, directly or indirectly, or through one or more transactions, shall:

(a) Acquire by purchase or otherwise any of the voting stock or shares of an insured institution not a subsidiary, or of a savings and loan holding company not a subsidiary, and in addition, in the case of a multiple savings and loan holding company, acquire or retain more than five percent of the voting shares of any company becoming a savings and loan holding company for more than one year after that and which is not a subsidiary but is engaged in any business activity other than those specified in of § 584.2(b) or § 584.2-1(b); or

(b) Acquire control of an uninsured institution or retain, for more than one year after other than an insured institution or holding company thereof, the date any insured institution subsidiary becomes uninsured, control of such institution.

§ 584.4-1 [Removed]

7. Remove § 584.4-1.

§ 584.10 [Amended]

8. Amend § 584.10 by removing paragraph (d) thereof and redesignating paragraph (e) as new paragraph (d).

PART 589—BOARD RULINGS

§ 589.1 [Removed]

9. Remove § 589.1.

§ 589.2 [Removed]

10. Remove § 589.2.

By the Federal Home Loan Bank Board.

Nadine Y. Penn,

Acting Secretary

[FR Doc. 85-27788 Filed 11-25-85; 8:45 am]

BILLING CODE 6720-01-M

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12 CFR Parts 543, 546, 552 and 563

[No. 85-[illegible]]

Delegated Merger Approvals; Principal Supervisory Agents Authority

Dated: November 8, 1985.

AGENCY: Federal Home Loan Bank Board.

ACTION: *Final rule.*

SUMMARY: The Federal Home Loan Bank Board ("Board") is amending its regulations which delineate the authority of its Principal Supervisory Agents ("PSAs") to approve applications involving mergers, consolidations, bulk transfers and other transfers of assets and liabilities, of thrift institutions whose deposits are insured by the Federal Savings and Loan Insurance Corporation ("Corporation") and federally-chartered savings banks whose deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The amendments are designed to facilitate expeditious disposition of such applications by significantly expanding the authority delegated to the Principal Supervisory Agents to approve, as well as to deny, applications. A new delegation to the Board's Washington staff of the transactions which fall outside of the authority delegated to the PSAs will also improve the timeliness of the Board's application procedures. In addition, the Board has issued a final rule delegating to the PSAs the authority to charter certain interim institutions which are used solely to facilitate other transactions in order to further expedite applications processing. Finally, the Board is amending and simplifying its rules regarding the rights of shareholders to an appraisal of their shares in connection with certain types of mergers and consolidations.

EFFECTIVE DATE: December 27, 1985.

FOR FURTHER INFORMATION CONTACT: R. Penfield Starke, Attorney (202-377-6453); Laura Patriarca, Deputy Director (202-377-6411); Julie L. Williams, Associate General Counsel, Director (202-377-6458); Corporate and Securities Division, Office of General Counsel, Federal Home Loan Bank Board, 1700 G Street, NW., Washington, D.C. 20552.

SUPPLEMENTARY INFORMATION: By Board Resolution No. 85-286, dated April 17, 1985, 50 FR (April 25, 1985), the Board proposed to amend its regulations delegating authority to its Principal Supervisory Agents to approve certain mergers, consolidations and bulk purchases or transfers of assets (collectively referred to as "mergers"), as well as other transfers of assets and liabilities, of insured institutions. Mergers involving federally-chartered savings and loan associations and savings banks ("federal associations") are subject to approval by the Board. 12 CFR 546.2, 552.13 (1985). Transactions that result in an increase in the insurable accounts of an institution whose deposits are insured by the Corporation ("insured institutions") are also subject to approval by the Board, as operating head of the Corporation. 12 CFR 563.22 (1985).

Under the Board's current regulations, certain mergers and increases in insurable accounts are deemed approved if no objection has been raised by the Principal Supervisory Agent (*i.e.*, the president of the Federal Home Loan Bank of which both the institutions are members) within 30 days after filing a completed merger application. An application qualifies for automatic approval unless any of the following circumstances is present:

(1) The resulting association requests the granting of supervisory forbearances;

(2) The principal Supervisory Agent recommends the imposition of nonstandard conditions prior to approving the merger;

(3) The application has been substantially protested;

(4) The Principal Supervisory Agent raises objections to the merger;

(5) The resulting association would be one of the 3 largest depository institutions competing in the relevant geographic area, where before the merger there were 5 or fewer depository institutions, the resulting association would have 25 percent or more of the total deposits held by depository institutions in the relevant geographic area, and the share of total deposits would have increased by 5 percent or more;

(6) The resulting association would be one of the 2 largest depository institutions competing in the relevant geographic area where before the merger there were 6 to 11 depository institutions, the resulting association would have 30 percent or more of the total deposits held by depository institutions in the relevant geographic area, and the share of total deposits would have increased by 10 percent or more;

(7) The resulting association would be one of the 2 largest depository institutions competing in the relevant geographic area where before the merger there were 12 or more depository institutions, the resulting association would have 35 percent or more of the total deposits held by depository institutions in the relevant geographic area, and the share of total deposits would have increased by 15 percent or more;

(8) The Herfindahl-Hirschman Index ("HHI") in the relevant geographic area is more than 1800 before the merger, and the increase in the HHI caused by the merger would be 50 or more;

(9) In a merger involving potential competition, the Principal Supervisory Agent determines that the acquiring association is one of 3 or fewer potential entrants into the relevant geographic area;

(10) Both the acquiring and an acquired association have assets of $1 billion or more;

(11) The association that will be the resulting association (other than an association that is neither insured by the Corporation nor chartered by the Board) in the merger has a composite Community Reinvestment Act rating of less than satisfactory, or is otherwise seriously deficient with respect to the Board's nondiscrimination regulations and the deficiencies have not been resolved to the satisfaction of the Principal Supervisory Agent;

(12) The resulting association's (other than an association that is neither insured by the Federal Savings and Loan Insurance Corporation nor chartered by the Board) net worth would not at least equal the Board's regulatory net-worth requirements. Where goodwill has been included in the resulting association's assets, the applicant must submit an opinion of a certified public accountant, satisfactory to the Principal Supervisory Agent, that its use and value are appropriate under, and accounted for, by generally accepted accounting principles. For purposes of this provision, in calculating whether the net

Exhibit 27

P.O. Box 56527, Peachtree Center Station, Atlanta, Georgia 30343.

By the Federal Home Loan Bank Board.

Nadine Y. Penn,

Acting Secretary.

[FR Doc. 86–3815 Filed 2-20-86; 8:45 am]

BILLING CODE 6720-01-M

[No. 86-90]

Privacy Act of 1974; New System of Records

Dated: February 3, 1986.

AGENCY: Federal Home Loan Bank Board.

ACTION: Notice of proposed new system of records.

SUMMARY: Pursuant to the requirements of the Privacy Act of 1974 (5 U.S.C. 552a), the Federal Home Loan Bank Board ("Board") is notifying the public of its proposal to establish a new system of records in order to collect information on known or suspected criminal violations and enforcement actions taken against persons in connection with the operation of financial institutions, their holding companies or service corporations, as well as change-of-control applications filed by, and other significant business transactions with, individuals concerning institutions the accounts of which are insured by the Federal Savings and Loan Insurance Corporation ("Corporation" or "FSLIC").

DATE: Comments must be received by March 24, 1986.

ADDRESS: Send comments to Director, Information Services Section, Office of the Secretariat, Federal Home Loan Bank Board, 1700 G Street, NW., Washington, DC 20552. Comments will be available for public inspection at this address.

FOR FURTHER INFORMATION CONTACT: John Downing, Attorney, (202) 377-6434 or Rosemary Stewart, Director, (202) 377-6437, Office of Enforcement, at the above address.

Authority: 5 U.S.C. 552a.

FHLBB-29

SYSTEM NAME:

Confidential Individual Information System.

SYSTEM LOCATION:

Federal Home Loan Bank Board, 1700 G Street, NW., Washington, DC 20552.

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

These records may contain information concerning individuals who have filed notices of intention to acquire control of an insured institution, controlling persons of companies that have filed applications to acquire control of an insured institution, organizers of institutions seeking FSLIC insurance of accounts or federal charters, individuals who have been the subject of administrative enforcement actions or other civil actions by any agency with authority to supervise or regulate federally insured financial institutions, those who have been named in criminal referrals by such agencies or by federally insured institutions or have been referred to professional societies, licensing authorities or ethics committees for disciplinary purposes, individuals identified as the subjects of criminal investigations by the Department of Justice or state law enforcement authorities in connection with the operation of federally insured financial institutions, and persons engaging in significant business transactions with FSLIC-insured institutions. This system also contains the identity of the custodian of any documents describing the specific event causing entry into the system.

CATEGORIES OF RECORDS IN THE SYSTEM:

The records identify the individual involved and his relationship to the institution, service corporation or holding company; the event causing entry of information into the system (e.g., a change-of-control filing, an enforcement action, a criminal referral naming an individual or a referral of information to a professional group for disciplinary action, or receipt of information concerning a criminal or civil violation involving an insured institution); any regulatory or judicial action taken as a result; and the location and nature of any additional records concerning the specific event.

AUTHORITY FOR MAINTENANCE OF THE SYSTEM:

12 U.S.C. 1464 and 1730.

ROUTINE USES OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING THE CATEGORIES OF USERS AND THE PURPOSES OF SUCH USES:

(a) To provide the Board's Office of Examinations and Supervision ("OES") and Office of Enforcement ("Enforcement") and the Federal Home Loan Banks with information concerning the current status of suspected criminal violations in connection with institutions the accounts of which are insured by the FSLIC, their holding companies, and service corporations, which have been referred to the Department of Justice or other law enforcement agencies for possible investigation and prosecution.

(b) To provide information to government agencies that supervise or regulate any of the operations of financial institutions concerning whether persons connected with these institutions have been the subject of administrative or civil enforcement actions.

(c) To provide information concerning a violation or potential violation of civil or criminal law, rule, order or regulation to the appropriate agency, whether Federal, State, local or foreign, charged with the responsibility of investigating or prosecuting such violation or implementing the statute, rule, regulation, or order.

(d) To provide information to third parties during the course of an investigation to the extent necessary to obtain information pertinent to the investigation.

(e) To respond to requests from the Congress.

(f) To provide information to the Office of General Counsel ("OGC"), OES and the Federal Home Loan Banks concerning groups or individuals applying for permission to organize a Federal association and/or making *de novo* applications for FSLIC insurance and the officers and directors of those proposed institutions, and concerning officers and directors of existing financial institutions applying for FSLIC insurance for use in considering those applications.

(g) To provide information to OGC, OES, Enforcement, and the Federal Home Loan Banks concerning persons who have filed notices of intention to acquire control of insured institutions and controlling persons of companies filing applications to acquire control of insured institutions to determine if any agency action is required.

(h) To provide information (1) to OES, Enforcement and the Federal Home Loan Banks examining and supervisory staffs with regard to persons transacting business with or for savings institutions in connection with the Board's examination and supervision of insured institutions, service corporations and savings and loan holding companies, and (2) to persons designated by the Board as representatives of the Corporation to conduct investigations of insured institutions, their service corporations, or their holding companies.

(i) To provide information to receivers or conservators of insured institutions or formerly insured institutions for use in determining the background and reliability of persons with whom they are considering entering into transactions or with whom the institution previously has entered into transactions.

(j) To OGC, Enforcement and persons representing the Board in legal matters, and to other persons having access to legal papers connected with such matters.

POLICIES AND PRACTICES FOR STORING, RETRIEVING, ACCESSING, RETAINING, AND DISPOSING OF RECORDS IN THE SYSTEM

STORAGE:

Records are maintained on fixed disks.

RETRIEVABILITY:

Records are retrievable by name of individual or by the individual's relationship to the insured institution involved.

SAFEGUARDS:

Access to the system will be available only to Board employees and agents who have been issued the system passwords, which will be revealed only to those persons who have need for information from the system in the performance of their duties.

RETENTION AND DISPOSAL:

Records will be retained for up to 25 years after the date of entry. Records will then be sent to the Federal Records Center.

SYSTEM MANAGER AND ADDRESS:

Database Administrator, Office of Examinations and Supervision, Federal Home Loan Bank Board, 1700 G Street, NW., Washington, DC 20552.

NOTIFICATION PROCEDURES:

This system will be exempt from notification and record-access requirements and requirements that an individual be permitted to contest its content under 5 U.S.C. 552a(k)(2) because it contains investigatory material compiled for law enforcement purposes.

RECORD ACCESS PROCEDURES:

See Notification procedures.

CONTESTING RECORD PROCEDURES:

See Notification procedures.

RECORD SOURCE CATEGORIES:

This system will be exempt under 5 U.S.C. 552a(k)(2) from the requirement that the sources of records used in the system be published, because it contains investigatory material compiled for law enforcement purposes.

By the Federal Home Loan Bank Board.

Nadine Y. Penn,

Acting Secretary.

[FR Doc. 86-3816 Filed 2-20-86; 8:45 am]

BILLING CODE [illegible]

FEDERAL MARITIME COMMISSION

Agreement(s) Filed

The Federal Maritime Commission hereby gives notice of the filing of the following agreement(s) pursuant to section 5 of the Shipping Act of 1984.

Interested parties may inspect and obtain a copy of each agreement at the Washington, DC Office of the Federal Maritime Commission, 1100 L Street, NW., Room 10325. Interested parties may submit comments on each agreement to the Secretary, Federal Maritime Commission, Washington, DC 20573, within 10 days after the date of the Federal Register in which this notice appears. The requirements for comments are found in § 572.603 of Title 46 of the Code of Federal Regulations. Interested persons should consult this section before communicating with the Commission regarding a pending agreement.

Agreement No.: 225-010887.

Title: General Agency Agreement between Hanjin Container Lines, Ltd. and Sea-Land Service, Inc.

Parties: Hanjin Container Lines, Ltd. (Hanjin) and Sea-Land Service, Inc. (Sea-Land).

Synopsis: The proposed agreement would permit Sea-Land to act on behalf of Hanjin as its general agent at the Port of Elizabeth, New Jersey for the carriage of cargo between ports and points in the Far East, and the United States. The parties have requested a shortened review period.

Dated: February 18, 1986.

By Order of the Federal Maritime Commission.

John Robert Ewers,

Secretary.

[FR Doc. 86-3845 Filed 2-20-86; 8:45 am]

BILLING CODE [illegible]

FEDERAL RESERVE SYSTEM

Agency Forms Under OMB Review

February 14, 1986.

Background

On June 15, 1984, the Office of Management and Budget (OMB) delegated to the Board of Governors of the Federal Reserve System (Board) its approval authority under the Paperwork Reduction Act of 1980, as per 5 CFR 1320.9, "to approve of and assign OMB control numbers to collection of information requests and requirements conducted or sponsored by the Board under conditions set forth in 5 CFR 1320.9." Board-approved collections of information will be incorporated into the official OMB inventory of currently approved collections of information. A copy of the SF 83 and supporting statement and the approved collection of information instrument(s) will be placed into OMB's public docket files. The following forms, which are being handled under this delegated authority, have received initial Board approval and are hereby published for comment. At the end of the comment period, the proposed information collection, along with an analysis of comments and recommendations received, will be submitted to the Board for final approval under OMB delegated authority.

DATE: Comments must be received within fifteen working days of the date of publication in the Federal Register.

ADDRESS: Comments, which should refer to the OMB Docket number (or Agency form number in the case of a new information collection that has not yet been assigned an OMB number), should be addressed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551, or delivered to room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may be inspected in room B-1122 between 8:45 a.m. and 5:15 p.m., except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information, 12 CFR 261.6(a).

A copy of the comments may also be submitted to the OMB desk officer for the Board: Robert Neal, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3208, Washington, DC 20503.

FOR FURTHER INFORMATION CONTACT: A copy of the proposed form, the request for clearance (SF 83), supporting statement, instructions, and other documents that will be placed into OMB's public docket files once approved may be requested from the agency clearance officer, whose name appears below: Federal Reserve Board Clearance Officer, Martha Bethea, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, DC 20551 (202-452-3822).

Proposal to approve under OMB delegated authority the extension with revisions of the following report:

1. Report title: Survey of Terms of Bank Lending (STBL)

Agency form number: FR 2028A, 2028A-S, 2028B

OMB Docket number: 7100-0061

Frequency: Quarterly

Reporters: Commercial banks

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COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
2129 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515

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JIM KOLBE ARIZONA
J ALEX McMILLAN NORTH CAROLINA

(202) 225-4247

January 14, 1986

The Honorable James A. Baker III
Secretary of the Treasury
Washington, D. C. 20220

Dear Mr. Secretary:

As you know, the Committee on Banking, Finance and Urban Affairs has legislative jurisdiction over the Bank Secrecy Act (the Act).

On March 5, 1985, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance invited then Assistant Secretary of the Treasury for Enforcement and Operations John M. Walker, Jr., and James D. Harmon, Jr., Executive Director of the President's Commission on Organized Crime, to brief the members of the Subcommittee on the state of compliance with the Act, on the efforts the Department of the Treasury was engaged in to enforce the Act, and on suggestions for changes in the law to enhance the Government's ability to carry out the Act.

The briefing was very helpful to the members of the Subcommittee. The briefing was followed in April by this Subcommittee's extensive investigations of the failure of the Bank of Boston and other Massachusetts banks to comply with the reporting requirements of the Act, as well as the institutional failure of the Office of the Comptroller of the Currency relative to their responsibilities under this law.

The Subcommittee intends to continue its review of the Act, examine suggested legislative changes, further inquire about the state of compliance by financial institutions, and possibly to conduct oversight hearings on the enforcement efforts that your Department and the banking regulators have undertaken since the Subcommittee's initiative last March.

In that regard, the Subcommittee would appreciate a comprehensive written report updating the activities and initiatives the Department and, specifically, the Office of Enforcement and Operations, have undertaken to see that

BEST COPY AVAILABLE

financial institutions are complying with all provisions of the Bank Secrecy Act. The Subcommittee would be most interested in hearing what additional manpower and other resources the Department has allocated to this effort.

The report should be submitted to the Subcommittee no later than February 10, 1986.

Sincerely,

Fernand J. St Germain
Chairman

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

FEB 14 1986

Dear Mr. Chairman:

The Secretary has asked me to respond to your letter dated January 14, 1986, which requested a written report concerning the activities of the Office of Enforcement and Operations to promote the compliance of financial institutions with the provisions of the Bank Secrecy Act (the Act).

Since March 5, 1985, when former Assistant Secretary Walker testified before the Subcommittee, the Office of the Assistant Secretary (Enforcement and Operations) has substantially increased its efforts to improve compliance with the Act. There has been an increased commitment of staff resources in the office itself, as well as by the IRS. In addition, bank supervisors and other agencies that have compliance responsibilities have focused their attention on the Act. This increased commitment has permitted us to make regulatory changes, shift administrative responsibilities, draft procedural changes, and place greater emphasis on the identification of violations and the settlement of related civil liabilities.

In July, 1985, the Treasury Department established the Office of Financial Enforcement to assist in implementing and administering the Bank Secrecy Act regulations. The establishment of this office provided a focal point for Bank Secrecy Act related activity within the Treasury Department and acknowledged the increasing importance of the Act in Treasury's law enforcement efforts. The office has broad responsibilities for the compliance activities of all agencies that have been delegated responsibilities under the Act, including the Federal bank supervisory agencies, the Federal Home Loan Bank Board, the National Credit Union Administration, the Securities and Exchange Commission, the Internal Revenue Service, and the U.S. Customs Service.

The Office of Financial Enforcement is currently staffed with an Acting Director, a Bank Secrecy Act Compliance Specialist, an Acting Data Systems Specialist, and two secretarial staff members. This represents an increase in staffing for the Bank Secrecy Act area since

March, 1985 of 150%. In addition, the Office of the General Counsel has provided the equivalent of more than one full-time staff attorney to provide assistance with drafting regulations and legislative proposals, reviewing potential civil penalty cases, and other legal work relating to the Act.

The increased emphasis within the Office of Enforcement and Operations has not been limited to the staff level. The former Assistant Secretary and the Deputy Assistant Secretary (Enforcement) have made the Bank Secrecy Act a high priority issue. During 1985, they made trips to Hong Kong, Panama, and Switzerland in order to meet with foreign officials and bankers to promote international cooperation in combatting the money laundering activities that often involve violations of the Act. Both officials accepted a number of invitations to speak to bankers and legal groups on money laundering and the enforcement of the Bank Secrecy Act.

As a result, in part, of the hearings which the Subcommittee on Financial Institutions Supervision, Regulation and Insurance held in April, 1985, concerning the Bank of Boston violations, an unexpectedly large number of major domestic banks have been identified as having violated the Bank Secrecy Act. The side effects of this unanticipated development included a very unusual increase in the number of currency transaction reports filed and the emergence of many violations that appear to warrant civil penalties. The number of filings increased from about 700,000 in 1984 to an estimated 1,700,000+ in 1985, which included a substantial number of reports of transactions that occurred in prior years. There have been approximately 136 banks identified as possible violators. If, however, the subsidiaries of holding companies are grouped by holding company, the number is much smaller, about 66.

While the Office of Financial Enforcement has been monitoring the processing and computerization of the huge increase in currency transaction reports, the IRS has felt the major impact of the increased workload. Although the IRS has been attempting to keep up with the increase by allocating additional resources, there currently is a backlog, which together with the normal work-in-process inventory amounts to more than 900,000 reports.

As of February 10, twelve banks or holding companies have entered into civil settlements with the Treasury Department and have paid almost $10 million. A list of these entities and copies of the twelve settlement agreements are enclosed.

We currently are in the process of extracting data from the Bank Secrecy Act data base to identify additional banks that appear to have violated the currency transaction reporting requirements. Within a few days, we expect to receive a listing of reports that were filed in 1985 concerning transactions that occurred in 1984 and prior years. Since the data base appears to be complete through August, 1985, the list should identify all of the banks that filed delinquent reports including those banks that failed to bring their violations to our attention. Preliminary estimates indicated that about 70,000 reports have been filed late. Our analysis of the data base information should result in a considerable number of additional penalty cases.

Late in 1985, the IRS agreed to assume the day-to-day responsibility for reviewing exemptions from the currency transaction reporting requirements and approving special exemptions under the provisions of 31 CFR 103.22(d). In January, 1986, the transfer was completed. We have been assisting the IRS during the transition stage. Their assumption of this responsibility has permitted us to devote more time to civil penalties and the improvement of bank examination procedures.

Over a period of several months, we have been meeting with the Federal bank supervisory agencies and others who have an interest in improving the procedures used by examiners for checking the compliance of financial institutions with the Bank Secrecy Act. As many of the civil penalty cases and the Bank of Boston case demonstrated, the procedures being used by the examiners did not detect the failure to report international bank-to-bank transactions. The gap in their instructions had to be closed, and a number of other issues also had to be considered in order to make compliance examinations more effective. These issues included the maintenance of detailed workpapers, the sharing of informa- tion among bank supervisory agencies, and the uniform application of the examination procedures. On January 8, 1986, we transmitted our recommendations to the supervisory agencies. A copy of Deputy Assistant Secretary (Enforcement) Queen's letter to the Division of Banking Supervision and Regulation, Federal Reserve System, is enclosed for your information. We plan to hold additional meetings with the agencies and develop a consensus on what the procedures should be. It is expected that the process will be completed within 60 days.

In addition, we have been working with the IRS to develop guidelines for bank examiners and others to use in reviewing a bank's retained copies of currency transaction reports (IRS Form 4789) for completeness. Since the Bank of Boston case, bank examiners generally have paid increased attention to the way in which the reports are prepared. With thousands of examiners in the field, there is a need to develop uniform standards to help them in evaluating the reports.

We are also assisting the IRS in their efforts to provide their staff members with written instructions and guidelines covering the review of bank exemption lists and the approval or denial of requests for special exemptions from the currency transaction reporting requirements. The guidelines for the review of exempt lists will also be made available to the bank supervisory agencies for the use of bank examiners in reviewing exemption lists as part of their compliance examinations. The IRS (Examination Division) is currently in the process of circulating a draft of those guidelines to the supervisory agencies for comment.

In an effort to streamline the initiation of criminal investigations of financial institutions, the IRS has been delegated authority to open criminal cases without obtaining approval from the Office of Enforcement and Operations. The IRS has agreed to review all requests for authority to open a case in its National Office. This should help to ensure the application of uniform standards and avoid unwarranted negative impact on the soundness of financial institutions.

We also worked with the IRS to develop a revision of IRS Form 4789, which financial institutions use to report currency transactions. The new form includes a number of improvements designed to require additional review by the preparing institution and to clarify the method for reporting currency transactions between financial institutions. We believe that the use of the revised form will improve the quality of the reports and focus accountability within the filing bank. It will also result in more accurate descriptions of transactions and consequently, it will facilitate our analysis of the data base and increase the value of the output. We expect that the form will be in use by the second half of 1986. A copy is enclosed for your information.

There were two major regulatory amendments after March, 1985. First, the final regulations which included casinos in the definition of "financial institution" and required them to file currency transaction reports became effective on May 7, 1985. Then, on August 7, 1985, the amendment governing the selective reporting of international transactions became effective.

During a recent meeting with Subcommittee staff members, our representatives agreed to provide information concerning current statutory authority for administrative subpoenas and summons issued by various Federal offices. A list of those offices and their statutory authority is enclosed. The Treasury Department believes that similar authority is necessary for the most effective enforcement of the Act.

I hope that this letter is responsive to your request. If you would like additional information, please let me know.

Sincerely,

Francis A. Keating, II
Assistant Secretary
(Enforcement & Operations)

The Honorable
Ferrand J. St Germain, Chairman
Committee on Banking, Finance
& Urban Affairs
House of Representatives
Washington, D.C. 20515

Enclosures

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

April 14, 1986

The Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and
Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

In response to your letter of March 27, 1986, we are pleased to provide a report updating the Subcommittee on our efforts to improve enforcement of the Bank Secrecy Act (BSA). The report includes detailed responses to the eight points mentioned in the letter. Together with the responses to the questions raised on the Financial Institutions Regulatory and Interest Rate Control Act of 1978 and the requested analysis of various bills dealing with money laundering appended to our testimony, it offers a comprehensive overview of what we have accomplished in the BSA area and progress we hope to see made in the future.

Since this Office testified before the Subcommittee last April on the BSA, we have taken strides to improve BSA compliance. We have focused management control over our BSA program, establishing a central clearinghouse for BSA operations and responsibilities in the Chief National Bank Examiner's office and designating focal points for BSA activities in the districts. We have intensified BSA training of examiners such that over half of our examiners received some BSA training last year. We have made a concerted effort to increase industry awareness of the BSA by participating in meetings to discuss the Act and by helping to develop a training segment for an American Bankers Association teleconference on the subject. And, we have taken an active role in establishing and facilitating interagency task groups on bank-related crime in general and BSA enforcement in particular.

In order to build on the progress that we have made in the BSA area over the past year, we will continue on-going training and efforts to heighten industry awareness. In addition, we will work toward increased interagency coordination and improved utilization of information to target BSA enforcement efforts.

While much has been accomplished since January 1985, more needs to be done. This Office is committed to its role in ensuring BSA compliance. But, law enforcement agencies and bank supervisors alone can provide only part of the answer. The industry's own commitment and efforts at self-policing are essential because banks' internal controls are the most effective mechanisms for promoting BSA compliance. With the legislative changes we urge in our testimony and active interagency cooperation and a committed industry, we are confident that substantial additional progress can be made in preventing the nation's financial institutions from being used, wittingly or unwittingly, to further criminal activity.

I look forward to working with the Subcommittee in the important task of improving BSA compliance.

Sincerely,

Robert L. Clarke
Comptroller of the Currency

EMBARGOED UNITL DELIVERY

Report to the

Subcommittee on Financial Institutions
Supervision, Regulation, and Insurance
Committee on Banking, Finance, and Urban Affairs
United States House of Representatives

Bank Secrecy Act Enforcement Since January 1, 1985

Office of the Comptroller of the Currency
April 14, 1986

The Office of the Comptroller of the Currency (OCC) has accomplished a great deal since January 1, 1985, in its efforts to improve national banks' compliance with the Bank Secrecy Act (BSA). Our efforts have proceeded along the lines set forth in our testimony before this Subcommittee on April 3, 1985. Specifically, as reported in our October 1985 six-month progress report and again in briefings for your staff in February of this year, we have improved training of our examiners, increased awareness and understanding of the Act's provisions in the national banking community, improved management control over our examination efforts, and worked to further effective enforcement by increasing coordination with Treasury, the other federal banking agencies, and the law enforcement community.

The following progress report responds to specific questions posed in your March 27, 1986, letter of invitation.

Question 1.

> The number of institutions examined by your agency since January 1, 1985, and the number and type of violations of the BSA found at these institutions, and actions taken by your agency on these violations.

During the period January 1, 1985, through December 31, 1985, OCC conducted approximately 4,150 examinations. These examinations varied in duration as well as scope. An examination may be conducted by one examiner for as little as a day or many examiners for several weeks. The scope of an examination may involve an analysis of a specific area of a bank's operation or a comprehensive analysis of the entire institution.

Of the 4,150 examinations, 1,084 identified violations of the BSA. The most frequently cited violation relates to improper completion of Form 4789, Currency Transaction Report (CTR). Common errors include incomplete addresses, improper identity verification, incomplete/incorrect name and address of reporting financial institution, incorrect identification number of financial institution, and failure to sign the CTR. Late filing of CTRs is also a problem, though to a lesser degree.

Another problem noted was the failure to file CTRs. A major problem involved the non-filing of CTRs on transactions with foreign banks. This problem relates to a 1980 change in the regulation which eliminated the exemption for transactions with foreign banks. Although we forwarded copies of the changed regulation to the national banks, it is apparent that many missed the change. Since early 1985, the banking community has become much more aware of this requirement, and we are now seeing fewer of these violations.

Some problems in complying with the exemption list requirement in the regulation have also been noted. Examiners have found instances where ineligible customers are included on exemption lists, exemption lists fail to include the required information, or the dollar amount of the exemption is suspect.

Banks have also been cited for recordkeeping violations. Foremost has been the failure to properly record a statement of purpose on loans in excess of $5,000 not secured by an interest in real property.

The majority of the BSA violations appear to result from the weaknesses in banks' internal controls and policies. However, through the efforts of all parties, enhanced compliance efforts within banks are being noted.

OCC submits all violations noted in examination reports to the Department of the Treasury on a quarterly basis. Where special attention is warranted, OCC makes a separate referral of the matter. More than 75 such referrals were made in 1985. These referrals had been made directly to Treasury's Office of the Assistant Secretary for Enforcement. In light of the recent delegation from the Secretary to the IRS, and in line with the suggestion of the new IRS/Financial Institutions Regulatory Working Group that was created in December of 1985, these separate referrals for consideration of criminal or civil penalties are now being sent directly to the IRS, Criminal Investigation Division (CID), with a copy provided to the Assistant Secretary for Enforcement. Once referrals have been made, our examiners and attorneys attempt to assist the agents of the IRS or other members of the law enforcement community as requested in their investigations.

Administratively, where a bank's systems need improvement, we direct that corrective actions be taken. In certain instances, OCC has used its formal enforcement powers to require that these actions be taken.

Question 2.

> Describe the training programs given to your examiners in BSA techniques and procedures. What improvements, if any, have been made since January 1, 1985?

OCC has enhanced the training of its examiners in the BSA. Through a variety of programs, instruction has been and continues to be provided to all levels of examining personnel.

- Training Crew

  Virtually every new examiner hired by the OCC is placed on a training crew for a period of at least six months. Crews consist of commissioned national bank examiners (leaders), seasoned associate examiners (assistants) and trainees. The program training manual specifically addresses BSA issues and was recently updated to improve the BSA segment. The training crews circulate to national banks and conducts examinations as a team. The training they receive is a combination of "classroom" sessions and on-the-job training. Part of the training agenda is to conduct BSA compliance examinations.

- District Staff Training Conferences

  In 1985, District staff training conferences were held for District examining personnel in all OCC Districts. Specialists from the Washington and District Offices conducted BSA training sessions at each. The participants in these sessions generally were examiners with at least two years experience. Senior examiners and district management also participated in the sessions.

  The purpose of the sessions was to: heighten BSA awareness; increase expertise; provide examination guidance and guidance for referring cases of noncompliance to Treasury/IRS; and address miscellaneous concerns and problems encountered in BSA.

- Associate National Bank Examiner School for Advanced Study

  This school is for examiners preparing for commission as a national bank/trust examiner. A special BSA section was written for the school and is part of the curriculum for 1986. The objectives of the course are twofold: to impart knowledge of BSA requirements and to ensure that attendees are knowledgeable of OCC's BSA examination procedures.

- Field Manager Meetings

  These meetings are attended by all supervising examiners, District management and certain District Office staff. A variety of issues are covered. In many instances, District policies and procedures are established for those items requiring such action. BSA was a significant topic in each District during 1985.

- White-Collar Crime School

  This school trains examiners in the detection of white-collar crime and how to work with law enforcement matters. Given four times a year, it is attended by senior commissioned examiners. A special segment has been developed on BSA and money laundering issues. Likewise, throughout the course the importance of working cooperatively with the law enforcement community is stressed.

- FBI/Financial Institutions Regulatory In-Service Program

  Pursuant to the recommendations of the Department of Justice/Financial Institutions Regulatory Working Group Agreement of April 2, 1985, a new training course jointly sponsored by the FBI and the bank regulatory agencies to be attended by senior FBI agents and senior examiners from each of the agencies was developed. The purpose of the course is to cross-train examiners from all of the federal financial institutions regulatory agencies and FBI agents in investigations and prosecutions. Since its inception, this course has been given a number of times in various locations throughout the country.

- Other Training

  OCC's Training and Development Division has established a computer-based technical progress evaluation for newly promoted examiners. This system has been implemented in each of the Districts. The purpose of the evaluation is to identify areas where an examiner requires additional training. BSA issues are a part of this program.

  The Uniform Commission Examination is given to all examiners progressing from the rank of associate national bank examiner to national bank examiner. This is a test of an individual's overall knowledge of laws, policies, and procedures. The incidence of BSA related material has been increased.

OCC is committed to developing and maintaining BSA knowledge of its employees at a high level. Their awareness and knowledge are further increased through our efforts to alert the banking industry and the public to BSA concerns.

Question 3.

> Describe efforts your agency has undertaken to improve communication with law enforcement agencies. What legal or policy impediments still exist that interfere with an open communication between the agency and law enforcement officials. Are they justified, in your opinion?

In late 1984, the OCC was instrumental in establishing the Justice/Financial Institutions Regulatory Working Group, consisting of senior officials from the OCC, U.S. Department of Justice Criminal Division, the FBI, the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC) and the Federal Home Loan Bank Board (FHLBB). The purpose of this group was to address common problems and to promote cooperation toward the goal of improving the Federal Government's response to white-collar crime in the Nation's federally regulated financial institutions. Through a series of meetings conducted first on a weekly basis and subsequently on a monthly basis, the working group made significant progress in a number of areas. Chief among these are the design and implementation of a standard criminal referral form for use by each of the supervisory agencies and institutions. The purpose of the form is to create a consistent manner of reporting suspected criminal offenses and to provide the Department of Justice with a better means to track criminal referrals. Each agency also worked to adopt new regulations, guidelines or policies similar to OCC's to require all regulated institutions to report potential criminal offenses to law enforcement.

Each agency and the Department of Justice also established a network of contacts on a national and local level who could be contacted for purposes of coordinating referrals and prosecutions. This list has been widely distributed and will be periodically updated.

The Department of Justice Fraud Section set up a tracking system to track significant cases (e.g., those involving significant amounts, or bank insiders). The FBI is currently developing a nationwide criminal referral tracking system to compile violations in order to prosecute repetitive offenders even if the amounts are de minimis.

The working group also recommended that a joint training course be developed to cross-train FBI agents and examiners. The agencies and the Department of Justice committed resources to this, and a formal training course was developed. A series of joint training sessions have since been held both at the FBI Academy at Quantico and at selected sites around the country.

The working group also made specific recommendations for needed amendments to the Right to Financial Privacy Act (RFPA) and the Grand Jury Secrecy Rules. Subsequent to the group's recommendation, the Administration proposed legislation to eliminate the major impediments to law enforcement cooperation contained in the RFPA and the Grand Jury Secrecy Rules. The group strongly backed amendments to the RFPA which would facilitate the ready exchange of information between the agencies and law enforcement authorities without additional notice. The group also supported revisions to the Grand Jury Secrecy Rules which would permit law enforcement authorities to share Grand Jury information with the agencies upon an appropriate showing that such information would raise supervisory concerns.

On April 2, 1985, the Attorney General and senior officials of each of the bank regulatory agencies signed an Agreement summarizing the understandings reached by the members of the working group and committing to continued cooperation in each of these areas. Since that time, the group has added to its membership representatives from the National Credit Union Administration and the Farm Credit Administration and continues to conduct monthly meetings on a variety of law enforcement issues. Representatives of the supervisory agencies also use this group as a vehicle for conducting regular meetings on civil enforcement matters.

Notwithstanding the significant progress accomplished through the working group, several very serious legal impediments still exist which interfere with full cooperation and coordination between and among the agencies and the law enforcement community. In addition to the the provisions of RFPA and the Grand Jury Secrecy Rules addressed by the working group, additional restrictions contained in various state privacy acts and the Freedom of Information Act continue to impede the full and open exchange of information. The OCC has testified previously before various committees of Congress concerning the specific problems raised by these statutes.

Question 4.

Describe the progress, if any, that has been made between your agency and the Federal Reserve regarding the type of currency shipment reports that are made available by the Fed. Has your agency made use of such reports? Be specific.

The Customs Service has periodically provided OCC with computer data analyses which have proven to be very useful in targeting compliance efforts. These analyses have permitted comparison of the CTR data with the FRB's currency shipment data to identify cases where a bank's CTR filings fail to correlate appropriately with its currency shipments to or from the Fed. Increased access to such analyses would improve OCC's ability to target its BSA compliance efforts and thus substantially increase the OCC's ability to effectively monitor BSA compliance.

In addition to encouraging increased availability of targeting analyses, OCC is working through the IRS/Financial Institutions Regulatory Working Group to obtain direct on-line access for our examiners to the Treasury Financial Law Enforcement Center CTR database. This access would permit the examiners to ensure that the CTR filings indicated in a bank's records are in fact reflected in Treasury's database.

Question 5.

Describe the management controls over implementation of BSA responsibilities that were in place before January 1, 1985, and changes, if any, since that time.

Although an integrated system of controls over OCC's examination process was in place prior to January 1, 1985, no separate controls existed over BSA compliance activities. Examinations were conducted pursuant to the Comptroller's Handbook for National Bank Examiners or, where specific information was available raising questions about a bank's BSA compliance, under special instructions from the district or field offices. If compliance problems were uncovered during the examination, OCC district management personnel were alerted and responded with appropriate follow-up action.

Information regarding BSA compliance was provided to OCC Washington headquarters and Treasury via a quarterly report which provides a compilation of the number of banks examined per calendar quarter and a listing of the BSA violations noted.

Since January 1, 1985 OCC has taken steps to strengthen management controls over BSA. BSA responsibility has been centralized under the Chief National Bank Examiner (CNBE) to streamline communication and provide effective monitoring of BSA compliance.

The CNBE's Office is responsible for: developing BSA examination policies and procedures; acting as liaison between OCC and other agencies charged with BSA oversight; maintaining lines of communication with respect to the BSA between the industry and OCC; reviewing BSA referral recommendations; and ensuring adequacy of examiner BSA training. Information flow has been better controlled by directing all BSA matters through the CNBE. Information such as U.S. Customs Service analyses of potential BSA compliance problems, Customs Service analyses of currency flows in certain areas of the United States, notification of IRS/Treasury BSA criminal investigations, and recommendations for referrals by bank examiners of banks in violation of BSA are all part of the flow of data through the CNBE's Office. These items are tracked by the CNBE's Office to ensure proper control and follow-up.

The CNBE's Office is supported by designated BSA specialists in each District. These individuals deal directly with examiners, bankers, and the CNBE's Office and are also available to conduct BSA training. This structure has served to streamline OCC's BSA oversight.

In addition to the CNBE's Office, the Enforcement and Compliance (E&C) Division in Washington plays an important role in the BSA process. This Division is involved in the recommendation of BSA referrals to Treasury/IRS for assessment of civil and/or criminal penalties. A designated individual is responsible for tracking referrals through the use of the Enforcement and Compliance Information System (ECIS), making recommendations on the cases to pursue and providing advice to field examiners. The District Office legal staffs likewise work closely with the District BSA specialists, the E&C attorneys, and representatives of the law enforcement community to coordinate OCC's efforts.

Finally, policies and procedures are being established which will formalize the referral process and fix specific responsibilities. Copies have been provided to the IRS/Financial Institutions Regulatory Working Group for review. Once the document is put in final form, a uniform set of criteria and procedures will be in place for all federal financial institutions regulatory agencies.

Question 6.

> Describe the initiatives your agency has taken to broaden knowledge of and exposure to reporting requirements of the BSA for those institutions you regulate.

OCC has advanced several different methods to broaden national bank knowledge of and exposure to the reporting requirements of BSA.

- Circulars

  Banking bulletins and banking circulars have been issued by OCC whenever needed to address problems with BSA. Since January 1, 1985, several new issuances dealing with BSA have been distributed.

- ** Banking Circular - 193, dated April 24, 1985

  Addressed lack of compliance with BSA, the requirements of the Act and the methods for bank management to provide information to OCC and the Department of the Treasury when violations are detected.

- ** Banking Circular - 193, Supplement 1, dated May 9, 1985

  Transmitted a copy of a Treasury Department opinion regarding the filing of Form 4790, Report of International Transportation of Currency or Monetary Instrument. The opinion clarified Treasury's position regarding banks' hiring private courier services to effect the international transportation of currency through a common carrier.

- ** Banking Circular - 193, Supplement 2, dated July 5, 1985

  Identified Detroit as the new location to which to forward CTRs, and provided the name of a Treasury Department contact for BSA questions.

- ** Banking Circular - 207, dated September 18, 1985

  Transmitted copies of the Criminal Referral Form designed by the Justice/Financial Institutions Regulatory Working Group. These forms are to be used by financial institutions to report instances of known or suspected crimes. The BSA is specifically listed on these forms together with specific referral instructions.

- ** Banking Bulletin - 85-27, dated December 20, 1985

  Transmitted a copy of an IRS press release regarding the revised Form 4789 which was to become effective January 1, 1986, with implementation July 1, 1986.

- ** Banking Circular - 193, Supplement 3, dated January 27, 1986

  Transmitted a copy of an IRS press release regarding IRS's new responsibility of reviewing exemption lists and reviewing requests for special exemptions.

- ** Banking Circular - 193, Supplement 4, dated March 27, 1986

  Distributed IRS's guidelines to banks who wish to request special exemptions from the financial reporting requirements of BSA.

- - Banking Bulletin - 86-9, dated April 9, 1986

    Many banks have been found to have submitted incomplete CTRs to IRS. These institutions are requested to correct and resubmit the CTRs. Because no formal criteria had been established for this process, banks would fill out a new CTR and submit it to IRS. The filing would be added to the data base causing a duplication. This bulletin provides IRS/Treasury's guidelines for filing amended CTRs to mitigate duplication.

  - Banking Circular - 171 and Supplement, dated January 3, 1985

    In addition to banking issuances addressing BSA, OCC has issued banking bulletins to the industry and the public alerting them to potentially fraudulent schemes perpetrated by certain offshore shell banks that may be operating improperly or illegally in the U.S. These bulletins continued through the year and were used to gather information for the use of banks and the law enforcement community.

- Comptroller's Manual for National Banks

  This is the OCC's manual containing summaries of relevant laws and regulations (including those pertaining to BSA) applicable to national banks. This manual is used by OCC's examiners and is distributed to all national banks. An update to the manual was issued in July 1985 addressing several changes in the BSA. In October 1985, several clarifying and non-substantive changes in the BSA regulations were listed in the Federal Register and became effective November 21, 1985. These "housekeeping" amendments will be included in the next regular manual update.

- Comptroller's Handbook for National Bank Examiners

  The Handbook contains the bank examination procedures used by OCC examiners. Separate BSA procedures are set forth. All national banks have copies of these procedures. The OCC has been working with a task group at Treasury to update and revise these procedures. Upon completion of Treasury's review, these new procedures will replace OCC's existing procedures and will be adopted by all of the financial institutions regulatory agencies. The revised version will be distributed to examiners and national banks. Banks will be encouraged to implement the procedures internally to assess compliance with BSA.

- American Bankers Association (ABA) Video Conference

  Together with the Federal Reserve and the FDIC, OCC played a central role in the development of a training segment entitled "Examiners" for use by the ABA in a BSA video conference which was presented in 61 locations across the country between September and November, 1985. Between 5,600 and 6,000 individuals attended these presentations. The regulatory agencies' segment developed to simulate examiner discussion of the results of an "examination" prior to meeting with bank management. The simulation illustrated what examiners look for in the BSA area during an examination and what banks should be doing to enhance BSA compliance.

- Speeches and seminars

  Over the past year, OCC representatives have spoken to various banking and legal groups about BSA problems and methods to ensure compliance. Many banks and private groups themselves also put on seminars concerning compliance with BSA.

- Newly Chartered Banks

  Prior to the opening of a newly chartered bank, OCC conducts a pre-opening examination. The purpose of this examination is to ascertain whether the bank has proper forms, manuals, systems and procedures to operate effectively. The OCC's Bank Organization and Structure Department is reviewing the pre-opening procedures to ensure that the BSA is adequately addressed.

Question 7.

> Describe the role your agency played in the Attorney General's Bank Fraud Working Group. Cite specific examples on how your agency has implemented that agreement.

The OCC was a prime mover and principal participant in the Justice/Financial Institutions Regulatory Working Group and continues to be a very active participant. Senior OCC officials are working members of the group, and the activities and recommendations of the group are fully discussed throughout the OCC.

Considerable time and resources have been devoted at OCC to design, create, and distribute the uniform criminal referral forms developed through the efforts of the working group. There are two such forms: one for major cases and one for *de minimis*, non-insider violations.

OCC has also been an active participant in the training programs developed and sponsored by the working group. OCC examiners have trained along with examiners from other agencies and FBI agents, and OCC provides instructors to assist in the program. In May of this year, working with the staff of the FBI Academy at Quantico, OCC's Southeastern District Office in Atlanta, Georgia, will sponsor a regional training program for examiners and FBI agents.

In October 1985, OCC proposed a regulation to replace its current Interpretive Rule that requires national banks to report violations of criminal law. Numerous comments were received from a variety of sources and the OCC is currently in the process of finalizing its regulation.

The other agencies are implementing similar regulations or guidelines. Thus, as well as there being consistency in the forms to be submitted, all financial institutions will be under a similar requirement to make referrals.

OCC continues to rely on and has enhanced its automated Enforcement and Compliance Information System (ECIS) to track criminal referrals. This system now enables us to track referrals and generates regular reports which are distributed by OCC's District Counsel to U.S. Attorneys for feedback on the status of referrals. In addition, customized reports on BSA referrals will be sent to the Treasury Department and the IRS. ECIS was recently expanded to include the most significant criminal referrals made by the other regulatory agencies and records of disciplinary actions taken by the OCC or the other agencies against bank officials. The system thus can also be used in our background investigations for new banks or in change in bank control applications.

Points of contact for law enforcement matters have been established in each District and in the Washington Office. District Counsel have been specifically required to establish and maintain contact with individual United States Attorneys' Offices, FBI offices, and strike forces for the purpose of establishing coordination for criminal matters. To add to the swiftness of response to law enforcement inquiries, we have formally delegated additional authority to the District Offices, permitting them to respond and provide information directly. We have likewise worked with representatives of the banking community to designate contacts within their organizations to ensure the swift handling of problems.

OCC has made copies of the working group's Agreement available to all national banks, seeking suggestions on how the Agreement can be improved. OCC representatives also make presentations to representatives of the industry to explain the importance of the criminal referral process.

OCC has also used the working group as a central point of contact and clearinghouse for the purpose of facilitating the exchange of information on matters that may cross between the jurisdictions of each agency.

Question 8.

> Submit copies of all revised regulations, banking circulars, newsletters, internal communications, updates to manual for examiners, and any other written information pertaining to enforcement efforts of the BSA undertaken by your agency since January 1, 1985.

See attached Appendix.

Appendix To

Office of the Comptroller of the Currency

Report to the
Subcommittee on Financial Institutions
Supervision, Regulation, and Insurance
Committee on Banking, Finance, and Urban Affairs
United States House of Representatives

April 14, 1986

1. Revised BSA Examination Procedures.

2. Comptroller's Manual for National Banks.
   - BSA implementing regulations, 31 C.F.R. Part 103.

3. Banking Circulars

   a. Banking Circular 193, dated April 24, 1985
   - reminds bank management of its ongoing responsibility to ensure compliance with all aspects of BSA.

   b. Banking Circular 193, Supplement 1, dated May 9, 1985
   - transmits a Treasury Department opinion on filing Report of International Transportation of Currency or Monetary Instruments.

   c. Banking Circular 193, Supplement 2, dated July 5, 1985
   - identifies new location to forward CTRs and provides Treasury Department contact for BSA questions.

   d. Banking Circular 193, Supplement 3, dated January 27, 1986
   - transmits IRS press release regarding IRS's new responsibility for reviewing exemption lists.

   e. Banking Circular 193, Supplement 4, dated March 27, 1986
   - distributes IRS guidelines to banks who wish to request special exemptions from the reporting requirements of BSA.

   f. Banking Circular 207, dated September 18, 1985
   - transmits the Criminal Referral Form.

   g. Banking Circular 171 and Supplements dated January 3, 1985
   - alerts industry to fraudulent schemes involving offshore shell banks.

   h. Banking Circular 141 and Supplements dated May 3, 1980
   - advises banks of "advance fee schemes" by fraudulent brokers.

4. Examining Circular 228, dated April 24, 1985
   - sets out guidelines for ensuring that national banks and federal branches and agencies comply with the Bank Secrecy Act.

5. Banking Bulletins
   a. Banking Bulletin - 85-27, dated December 20, 1985
      - transmits copy of IRS press release regarding the revised Form 4789.

   b. Banking Bulletin - 86-9, dated April 9, 1986
      - outlines procedure for correction and resubmission of incomplete CTRs to IRS.

6. Employee Newsletter Articles

   a. Bank Supervision Newsletter, dated July, 1985
      - discusses ramification of BSA for trust departments.

   b. Bank Supervision Newsletter, dated August, 1985
      - discusses changes to 31 CFR 103 promulgated through August, 1985.

   c. Bank Supervision Newsletter, dated October, 1985
      - provides information relative to referring BSA violations to the Treasury Department.

   d. SuperVision, dated February, 1986
      - discusses IRS responsibilities for exemption lists.

   e. SuperVision, dated March, 1986
      - provides IRS contact numbers for BSA inquiries.

7. Proposed amendments to 12 CFR Parts 7 and 21
   - designed to make report filing more efficient for banks and more useful for law enforcement agencies in identifying patterns of criminal activity and apprehending persons who commit crimes involving national banks.

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

To David D. Queen, Deputy Assistant Secretary (Enforcement and Operations)

From John F. Downey, Chief National Bank Examiner J Downey

Date March 27, 1986

Subject Revised Bank Secrecy Act Examinations Procedures

Over the past several months, representatives of the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, National Credit Union Administration (NCUA) and your office have met to revise the BSA examination procedures. The working group has now completed the project.

With the exception of the NCUA, who is continuing to evaluate the final document, the working group has agreed upon the revised examination procedures. Each of the regulatory agencies will be responsible for the immediate distribution and implementation of the procedures.

Enclosed, for your use, is a copy of the revised procedures. If there are any questions, please contact me.

Enclosure

cc: Richard Schrieber, Board of Governors of the Federal Reserve System
Michael Bianchetta, Federal Deposit Insurance Corporation
Cynthia Graae, Federal Home Loan Bank Board
Hattie Ulah, National Credit Union Administration
Brian Bruh, Internal Revenue Service
Bill Landreth, Department of the Treasury

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Financial Recordkeeping and Reporting Regulations
Introduction

General

As a means to detect the incidence of money laundering, for any of a multitude of illicit activities, the Financial Recordkeeping and Reporting of Currency and Foreign Transactions Reporting Act, the Bank Secrecy Act, was enacted October 26, 1970. Among other things, the Act allows the Department of the Treasury (Treasury) to delegate certain compliance responsibilities to other governmental agencies. In an effort to ensure compliance with the Act by bank and nonbank financial institutions, Treasury delegated supervisory authority to the financial institution regulators.

Different methods are available for selecting financial institutions for examination. These include:

- o Scheduled examinations - an identified core group of institutions which will be examined on a regular basis,
- o Targeting - identifying financial institutions for special investigations based upon analyses of financial or other data, and/or
- o Sampling - selecting institutions for examination by randomly sampling a specific population.

Each regulatory agency has its own policy which addresses the examination schedule. The use of the above methods is determined independently by each agency.

Procedural

The following procedures for testing compliance with Financial Recordkeeping and Reporting Regulations (Bank Secrecy Act), 31 CFR 103, are set forth in two separate modules which are progressively extensive in scope. The first module includes "stops" which provide the examiner with the opportunity to determine whether the examination can be concluded or whether the examiner should continue.

Module I requires the examiner to establish that the examined institution has appropriate operating and auditing standards. In addition, it requires the examiner to conduct a detailed review of the institution's internal audit function and entails the examination of procedures and selected workpapers, reports and responses. The review of auditing methodology and implementation enables the examiner to determine the scope of the examination.

Module II sets forth guidelines for the examiner in conducting a review of a sample of actual transactions and related documentation.

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MODULE I

The purpose of this module is to determine that the financial institution under examination has established operating standards and audit procedures that ensure compliance with the requirements of the Financial Recordkeeping and Reporting of Currency and Foreign Transaction Act, 31 CFR 103.

It is recognized that the reporting requirements will not be applicable to those credit unions which do not conduct cash transactions.

PROCEDURES

1. The examiner should ascertain that the institution has established in writing formal operating procedures to ensure compliance with the regulations. Review the institution's policies and procedures, internal controls and training regarding the Act.

   a. Reporting -- Operating procedures should set forth the requirements of the regulations and establish compliance guidelines with respect to large cash transactions and exemptions granted to customers.

   b. Recordkeeping -- The institution's record retention schedule should, at a minimum, include the record retention requirements of the regulations. Furthermore, requirements for the maintenance of lists of exempt customers from whom taxpayer identification numbers have not been obtained should be included.

2. Obtain a copy of the institution's list of exempt customers and review the institution's correspondence with the Internal Revenue Service (IRS) or Department of the Treasury (Treasury) regarding exemptions. Through a review of these documents, determine:

   a. that the exemption list conforms to the requirements of the regulations (name, address, business, nine digit Federal taxpayer identification number, reason for exemption, etc.) (103.22(e)), and that the exemptions appear reasonable.

b. that the institution has, in granting exemptions, adhered to its established policy and has documentation to support the limits established.

c. if a denial for a special request for exemption from the reporting requirements has been sent to the institution. If so, ascertain that currency transaction reports are being filed on that customer when a reportable transaction occurs. If the number of denials is large, select a sample to review.

3. The examiner should review the file of reports submitted (forms 4789 and 4790) and ascertain that they are properly completed and filed as required. Review correspondence from IRS/Treasury to be cognizant of incorrect or incomplete CTRs returned to the institution for corrective action. Follow-up on the disposition of these forms.

4. The examiner should ascertain that the institution has established a program of employee education with regard to the requirements of the regulations.

   a. Tellers, through an ongoing training program, should be apprised of the reporting requirements for large cash transactions.

   b. Operations personnel should be made aware of the current requirements of the regulations and management should periodically reinforce the importance of compliance.

   c. Knowledge of the regulations and operating procedures should be ascertained by interviewing the following: the institution's management, auditors, internal control personnel, tellers, platform personnel, branch managers and personnel in cash vault operations.

   Determine if currency transactions are conducted in other areas of the institution such as the trust department, bank dealer department, loan department and international department. If so, ascertain that personnel which handle currency in these departments are knowledgable of the regulations and operating procedures. Determination of how these individuals became knowledgable of the regulations should be documented (i.e., initials on a circular, attendance at training sessions, attending seminars, etc.)

Procedure 5 is to be omitted if the institution does not have an internal audit function. In such cases, the examiner should ascertain that a program of management reviews or self audits has been established which encompasses the requirements of the regulations.

5. The examiner should test the institution's audit procedures and determine that internal audit function provides coverage of the following sections of the regulations.

   a. Reporting -- Coverage of the reporting requirements should be found in the procedures and should include a review of actual tellers' work and Forms 4789 and 4790.

   b. Recordkeeping -- Coverage of the institution's recordkeeping activities should encompass a test of adherence to the in-house record retention schedule. It is understood that this schedule should meet the requirements of the regulations.

   c. Exemptions -- Coverage should include audit steps necessary to ascertain that the institution is maintaining a list of exempt customers which includes their affiliations as required by the regulations. The examiner should expect the audit procedure to provide a test of the reasonableness of the exemptions granted.

   d. Foreign Accounts -- Coverage in this area should require the auditor to ascertain that the institution has filed Form 90-22.1, if applicable, declaring interest in a foreign financial account.

6. The examiner should review the results of the prior examination report and follow-up on any deficiencies.

7. The examiner should review the totals of cash shipped to and/or received from the Federal Reserve Bank (reported on Form MD-115) or correspondent bank during the last six months. If, in the examiner's judgement, that amount appears high in relation to the amount the institution has reported on Form 4789 for the last six months, the examiner should discuss the findings with management, substantiate the explanation and document it in the workpapers.

During this process the examiner may become aware of unusual currency flows from correspondent banks. If this occurs, the examiner should convey such findings to a supervisor. Ultimate dissemination should be made to other examiners or financial institution regulatory agencies.

STOP

At this point, the examiner has to exercise judgement in deciding whether further examination and testing is needed.

- If the examiner is satisfied with the results from the steps above, the findings should be summarized in workpapers.
- If, however, it is determined that further work is warranted, the examiner should implement Module II.

MODULE II

The purpose of this module is to conduct on-site examination of teller operations relative to Financial Recordkeeping and Reporting Regulations. This module sets out procedures and guidelines the examiner should use when conducting test checks for compliance with the regulations. Criteria for selection of branches for detailed review are listed along with general guidelines applicable to either multiple or single office financial institutions.

This phase of the examination should include a minimum of five to ten days of transactions and one to three branch offices. Branch examinations should encompass a review of the work of selected tellers within the days selected.

The selection of tellers should be governed by the institution's internal procedures. For example, if it is the institution's practice to direct all large currency transactions to specific tellers, the examiner may concentrate on the work of those tellers. In the absence of such procedures, or if the procedures are not being followed, the work of all tellers should be reviewed.

I. Complete Exhibits A and B: A Review of Currency Distribution/Cash Control Center and Branch Operations

A. Submit Exhibit A, the Currency Distribution and Cash Control Center Letter and its attached Currency Shipment/Distribution Report to the Officer-in-Charge of the Center.

B. If branches ship directly to a Federal Reserve Bank or a correspondent institution, then a copy of Exhibit A must be submitted to every branch that does ship currency directly to a Federal Reserve or correspondent institution.

C. Check the records maintained at the currency distribution/cash control center or the branch to ensure that the information in those records is compatible with information provided by the Officer-in-Charge in Exhibit A and the guidelines outlined below. (See Section II)

D. A Branch Office Letter (Exhibit B) should be personally addressed and sent to every branch.

II. Guidelines for Selection of Branches for On-Site Review

A. In reviewing the information provided in Exhibits A and B, examiners should use the following criteria to select branches for on-site review:

1. Branch requests for large denomination currency represent the most significant portions of their total branch currency requirements;

2. Branch requests for large denomination currency are significantly greater than average branch requirements;

3. Branch does not ship large denomination currency;

4. Branch reports no exempt list;

5. Branch manager would not sign the statement (Exhibit B); and

6. Branch is characterized by unusual cash transactions with the Cash Control Center, Federal Reserve Bank, or correspondent institution .

B. In the absence of significant leads, consider selection of branches for on-site review by sampling on a random basis.

III. General Guidelines for On-Site Review

A. When at the office location, the examiner is to review the work of selected tellers with a specific time period. (See above criteria for selection of tellers. Recommended time period: minimum five days, preferably ten days.) The examiner should take into account the time period allowed for filing forms 4789 or 4790 in selecting the time frame in which the examination will be conducted. For example, if the date of examination is 12/31/80, the grace period for filing is 15 days, and the examiner is reviewing transactions for two weeks, or 14 days, then the examiner should review transactions at least 29 days before 12/31/80.

B. Obtain, for selected tellers, completed cash proof sheets for as many consecutive dates as are practical. From a day-to-day comparison of total $50 and $100 bills, determine specific tellers who experienced a significant ($10,000) fall-off in these denominations that is not supported by the tellers' transactions. Incidents of this type should be reported to the examiner-in-charge as possible evidence of currency washing.

IV. Review Procedures for Selected Tellers and Selected Dates

A. Obtain and review tellers' documentation for the selected dates.

B. Note any cash-in or cash-out transactions of more than $10,000.

C. In instances where such transactions were discovered, determine the type of transaction and if it was reported. Transactions with non-exempt customers which were not reported should be researched to ascertain if they are truly subject to the regulation.

D. Review consecutive transactions which total in excess of $10,000 to ascertain if they were made by or for one depositor.

E. The following transactions should be checked. While performing the following steps, the examiner should be aware of repetitive currency transactions by a customer or in an account or group of accounts controlled by one entity. Based on the activity, the customer or account(s) may be targeted for additional investigation of currency transactions occurring in different time periods.

1. Cashed checks -- Items should be traced to ascertain if they are a cash-out of more than $10,000 or part of a split transaction. Split transactions which do not involved a cash-out of more than $10,000 should be eliminated.

2. Cash deposits -- Any transaction involving the receipt of more than $10,000 cash.

3. Savings withdrawal -- Cash withdrawals of more than $10,000.

4. Personal money orders or official checks sold -- Any sale for more than $10,000 cash must be reported, even to an exempt customers. Be aware of consecutive items sold. A check of paid items could reveal that they were sold to the same customer.

5. Savings bonds sold or cashed -- Transactions involving more than $10,000 cash.

6. Official checks cashed -- Cash-outs of more than $10,000.

7. Loans -- Note teller receipt or pay-out of more than $10,000 cash.

8. Securities sold or purchased -- If the institution acts as agent for an individual and the transactions involves more than $10,000 cash.

9. Fiduciary powers -- if the institution's trust department is conducting currency transactions for customers which exceed $10,000.

10. Wire department -- wire transfer and telex logs to determine cash transactions exceeding $10,000.

11. Other areas -- investigate other areas of the institution where currency transactions exceeding $10,000 may be occurring.

F. The examiner should obtain and review the list of exempt customers. Lists which appear inordinately long or which contain names of customers the size or nature of whose business would not ordinarily merit exempt status should be discussed with management of the institution under examination. If after discussion with management the examiner feels that criticism may still be warranted, the matter should be referred to the examiner's supervision department or district office.

V. List Exceptions for Possible Inclusion in the Report of Examination/Supervisory Letter

A. Determine the severity of noncompliance with the Act and management's attitude toward compliance. Violations and poor internal controls may warrant a civil or criminal referral to the Department of the Treasury. Report comments should not include references regarding the willfulness of a violation or act on the part of the institution or its employees.

CURRENCY DISTRIBUTION AND CASH CONTROL CENTER LETTER

Date:___________

____Officer-in-Charge Branch#:_________
Currency Distribution/Cash Control Center

____Location

Dear Sir/Madam:

In order to facilitate our review for compliance with Financial Recordkeeping and Reporting Regulations, please submit the following information. Supporting source records should be made available for review upon request.

____
Examiner

Please provide, according to the attached format, the following information for the period ________________ to ________________, inclusive.

1) For branches which ship and receive currency through a central currency distribution center within the institution please provide:
    a) A list of all currency shipments between the distribution center and the Federal Reserve Bank or correspondent institution;
    b) A list, by branch, of all currency shipments between the distribution center and branches;
    c) A list of currency shipments between branches;
    d) A list of branches which have shown a significant increase in their use of large bills during the past twelve months, either as a portion of their total shipment of currency or in comparison to other branches.
2) For branches which transact (ship and/or receive currency) with the Federal Reserve Bank or correspondent institution;
    a) A list of all currency transactions between the branch and the Federal Reserve Bank or correspondent institution;
    b) A list of all currency transactions with other branches.
3) Copies of all correspondence with the Department of the Treasury or the Internal Revenue Service regarding exemption lists, requests for special exemptions and incorrectly filed CTRs.

Signed ________________________
(Title and Position)

CURRENCY SHIPMENT/DISTRIBUTION REPORT

from ____________ to ____________

Officer-in-Charge ____________________

Institution Name ____________________

Location ____________________

CURRENCY RECEIVED				CURRENCY SHIPPED			
Date	Received from	Total amount of shipment	Total amount of large ($50's & $100's bills)	Date	Shipped to	Total amount of shipment	Total amount of large ($50's & $100's bills)

(Signed) ____________________
(Title and Position)

____
Date

Exhibit B

BRANCH OFFICE LETTER

Date:____________________

____________________, Officer-in-Charge
____________________, (Office)
____________________, (Location)

Dear Sir/Madam:

To facilitate our examination of compliance with Financial Recordkeeping and Reporting Regulations under Public Law 91-508, please furnish the examiner-in-charge with the information listed below.

____
Examiner

1) A copy of your list of customers who normally have currency transactions over $10,000 (exempt customers).

2) Describe how currency transactions over $10,000 for customers are recorded and reported by individual tellers at your office.

3) Describe the records used at your office to document, by denomination, currency transfers between tellers, including transfer from and to vault cash.

4) Name of person in your office who is responsible for filing Currency Transaction Reports (Form 4789).

5) Indicate where copies of all Currency Transaction Reports (Form 4789) prepared by your office are maintained.

6) A list of transactions for which Currency Transaction Reports (Form 4789) are due to be filed but have not yet been submitted by your office.

7) If periodic reviews are conducted by office management of exempt customers to ensure that their status has not changed under Recordkeeping and Reporting Regulations, please make supporting documentation available, including:

BEST COPY AVAILABLE

a) dates of last two reviews;
b) description of work reviewed;
c) names of individuals who conducted the review and their findings.

* * * * * *

Currency Transaction Reports (Form 4789) have been completed for all required transactions. Lists of customers who normally have currency transactions over $10,000 (exempt customers) are currently maintained.

(Signed)____________________
Office Manager

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

July 26, 1985

TO: SUBSCRIBERS TO THE COMPTROLLER'S MANUAL FOR NATIONAL BANKS

Attached is an interim supplement to the Comptroller's Manual for National Banks. It contains changes to the "Laws" and "Regulations" sections of the Manual, relating to the Currency and Foreign Transactions Reporting Act, Title 31 of the United States Code.

The changes in the law reflect a general recodification and incorporate statutory amendments enacted in October 1984. The changes in the regulation represent numerous amendments to 31 CFR 103 which were not previously published in the Manual. Sections that should be especially noted are:

103.11. Amended in February 1985. Incorporated gambling casinos within the definition of "financial institution," subjecting them to the reporting and recordkeeping requirements contained in all sections of the act. Amended July 1985. Incorporated new definition of foreign financial agency.

103.23(a). Amended in May 1985. Increased the reporting requirement from $5,000 to $10,000.

103.25. Added in July 1985. Established a regulatory procedure through which the Secretary of the Treasury can require financial institutions in the United States to submit reports of financial transactions with foreign financial agencies.

103.34. Amended in May 1978. Required banks to make and retain additional records on certificates of deposit.

103.47 and 103.49. Amended in May 1985. Implemented new and increased civil and criminal penalties. These were enacted into law in conjunction with the Comprehensive Crime Control Act of 1984.

Appendices. Amended in June 1978. Revoked Interpretation 8 to Sec. 103.34(a), which exempted bearer certificates of deposit from recordkeeping requirements.

Please discard the copy of 31 CFR 103 attached to Banking Circular 193 and replace it with a copy of the one included in this supplement.

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Part 103—Financial Recordkeeping and Reporting of Currency and Foreign Transactions

[31 CFR 103]

Subpart A—Definitions

Sec.
103.11 Meaning of terms

Subpart B—Reports Required To Be Made

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103.36 Additional records to be made and retained by casinos
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Appendix—Interpretations and Exemptions

Authority: Sec 21 of the Federal Deposit Insurance Act, Pub. L. 91–508, Title I, 84 Stat. 1114, 1116 (12 USC 1829b, 1951–1959); and the Currency and Foreign Transactions Reporting Act, Pub. L. 91–508, Title II, 84 Stat. 1118, as amended (31 USC 5311–5322).

Subpart A—Definitions

§103.11 Meaning of terms

When used in this part and in forms prescribed under this part, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in this section.

Bank. (a) Each agency, branch or office within the United States of any person doing business in one or more of the capacities listed below:

(1) A commercial bank or trust company organized under the laws of any State or of the United States;

(2) A private bank;

(3) A savings and loan association or a building and loan association organized under the laws of any State or of the United States;

(4) An insured institution as defined in section 401 of the National Housing Act;

(5) A savings bank, industrial bank or other thrift institution;

(6) A credit union organized under the laws of any State or of the United States; and

(7) Any other organization chartered under the banking laws of any State and subject to the supervision of the bank supervisory authorities of a State.

(b) Each agent, agency, branch or office within the United States of a foreign bank.

Broker or dealer in securities. A broker or dealer in securities, registered or required to be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

Currency. The coin and currency of the United States or of any other country, which circulate in and are customarily used and accepted as money in the country in which issued. It includes U.S. silver certificates, U.S. notes and Federal Reserve notes, but does not include bank checks or other negotiable instruments not customarily accepted as money.

Domestic. When used herein, refers to the doing of business within the United States, and limits the applicability of the provision where it appears to the performance by such institutions or agencies of functions within the United States.

Financial institution. Each agency, branch, or office within the United States of any person doing business in one or more of the capacities listed below:

(1) A bank (except bank credit card systems);

(2) A broker or dealer in securities;

(3) A person who engages as a business in dealing in or exchanging currency as, for example, a dealer in foreign exchange or a person engaged primarily in the cashing of checks;

(4) A person who engages as a business in the issuing, selling, or redeeming of travelers' checks, money orders, or similar instruments, except one who does so as a selling agent exclusively or as an incidental part of another business;

(5) A licensed transmitter of funds, or other person engaged in the business of transmitting funds abroad for others.

(6)(i) A casino or gambling casino licensed as a casino or gambling casino by a State or local government and having gross annual gaming revenue in excess of $1,000,000.

(ii) A casino or gambling casino includes the principal headquarters and any branch or place of business of the casino or gambling casino.

Foreign bank. A bank organized under foreign law, or any agency, branch or office located outside the United States of a bank. The term does not include an agent, agency, branch or office within the United States of a bank organized under foreign law.

Foreign financial agency. A person acting outside the United States for a person (except for a country, a monetary or financial authority acting as a monetary or financial authority, or an international financial institution of which the United States Government is a member) as a financial institution, bailee, depository trustee, or agent, or acting in a similar way related to money, credit, securities, gold, or a transaction in money, credit, securities, or gold.

Investment security. An instrument which:

(1) Is issued in bearer or registered form;

(2) Is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment;

(3) Is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(4) Evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

Monetary instruments. Coin or currency of the United States or of any other country, travelers' checks, money orders, investment securities in bearer form or otherwise in such form that title thereto passes upon delivery, and negotiable instruments (except warehouse receipts or bills of lading) in bearer form or otherwise in such form that title thereto passes upon delivery. The term includes bank checks, travelers' checks and money orders which are signed but on which the name of the payee has been omitted, but does not include bank checks, travelers' checks or money orders made payable to the order of a named person which have not been endorsed or which bear restrictive endorsements.

Person. An individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, and all entities cognizable as legal personalities.

Secretary. The Secretary of the Treasury or any person duly authorized by the Secretary to perform the function mentioned.

Transaction in currency. A transaction involving the physical transfer of currency from one person to another. A transaction which is a transfer of funds by means of bank check, bank draft, wire transfer, or other written order, and which does not include the physical transfer of currency is not a transaction in currency within the meaning of this part.

United States. The various States, the District of Columbia, the Commonwealth of Puerto Rico, and the territories and possessions of the United States.

Subpart B—Reports Required To Be Made

§103.21 Determination by the Secretary

The Secretary hereby determines that the reports required by this subpart have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.

§103.22 Reports of currency transactions

(a)(1) Each financial institution other than a casino shall file a report of each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or to such financial institution, which involves a transaction in currency of more than $10,000. Such reports shall be made on forms prescribed by the Secretary under 31 CFR 103.25(a) and all information called for in the forms shall be furnished in accordance with 31 CFR 103.25(a).

(2) Each casino shall file a report of each deposit, withdrawal, exchange of currency, gambling tokens or chips, or other payment or transfer by, through, or to such casino which involves a transaction in currency of more than $10,000. Such reports shall be made on forms prescribed by the Secretary under 31 CFR 103.25(a) and all information called for in the forms shall be furnished in accordance with §103.25(a). (OMB Control number 1505-0087)

(b)(1) Except as otherwise directed in writing by the Assistant Secretary (Enforcement and Operations), this section shall not: (i) Require reports of transactions with Federal Reserve Banks or Federal Home Loan banks; (ii) require reports of transactions between domestic banks; or (iii) require reports by nonbank financial institutions of transactions with commercial banks.

(2) Except as otherwise directed in writing by the Assistant Secretary (Enforcement and Operations), a bank may exempt from the reporting requirement of this section the following:

(i) Deposits or withdrawals of currency from an existing account by an established depositor who is a United States resident and operates a retail type of business in the United States. For the purpose of this subsection, a retail type of business is a business primarily engaged in providing goods to ultimate consumers and for which the business is paid in substantial portion by currency, except that dealerships which provide automobiles, boats or airplanes are not included and their transactions are not exempt from the reporting requirement of this section.

(ii) Deposits or withdrawals of currency from an existing account by an established depositor who is a United States resident and operates a sports arena, race track, amusement park, bar, restaurant, hotel, check cashing service licensed by state or local governments, vending machine company, or theater.

(iii) Deposits, or withdrawals, exchanges of currency or other payments and transfers by local or state governments, or the United States or any of its agencies or instrumentalities.

(iv) Withdrawals for payroll purposes from an existing account by an established depositor who is a United States resident and operates a firm that regularly withdraws more than $10,000 in order to pay its employees in currency.

(c) In each instance the transactions exempted under paragraph (b) of this section must be in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the lawful, domestic business of that customer, or in the case of transactions with a local or state government or the United States or any of its agencies or instrumentalities, in amounts which are customary and commensurate with the authorized activities of the agency or instrumentality. This section does not permit a bank to exempt its transactions with a nonbank financial institution.

(d) A bank may apply to the Secretary for additional authority to grant an exemption to the reporting requirement, not otherwise provided for under paragraph (b) of this section, if the bank believes that circumstances warrant such an exemption. Such requests should be addressed to:

Exemption Staff, Room 1134, Office of Enforcement and Operations,
U.S. Treasury Department, Washington, D.C. 20220

(e) A record of each exemption granted under paragraph (b) of this section and the reason therefore must be made at the time it is granted and all such exemptions must be kept in a centralized list. The record shall include the names and addresses of the banks referred to in paragraph (b)(1)(ii) of this section, as well as the name, address, business, taxpayer identification number, and account number of each depositor that has engaged in currency transactions which have not been reported because of the exemption provided in paragraph (b)(2) of this section. The record concerning the group of depositors exempted under the provisions of paragraph (b)(2) of this section should also indicate whether the exemption covers withdrawals, deposits, or both, as well as the dollar limit of the exemption. Upon the request of the Secretary, a bank shall provide a report containing the list of the bank's customers whose transactions have been exempted in accordance with the provisions of paragraph (b) of this section and such information as the Secretary may require. The exemptions may be reviewed by the Secretary who may require a bank to file the usual reports as prescribed in paragraph (a) of this section with respect to any customer whose transactions have been previously exempted.

(f) Reports required under paragraph (e) of this section must be mailed or otherwise delivered to the Secretary within 30 days after the bank receives the Secretary's request.

§103.23 Reports of transportation of currency or monetary instruments

(a) Each person who physically transports, mails, or ships, or causes to be physically transported, mailed, or shipped or attempts to physically transport, mail or ship, or attempts to cause to be physically transported, mailed or shipped, currency or other monetary instruments in an aggregate amount exceeding $10,000 on any one occasion from the United States to any place outside the United States, or into the United States from any place outside the United States, shall make a report thereof. A person is deemed to have caused such transportation, mailing or shipping when he aids, abets, counsels, commands, procures, or requests it to be done by a financial institution or any other person. A transfer of funds through normal banking procedures which does not involve the physical transportation of currency or monetary instruments is not required to be reported by this section.

(b) Each person who receives in the U.S. currency or other monetary instruments in an aggregate amount exceeding $5,000 on any one occasion which have been transported, mailed, or shipped to such person from any place outside the United States with respect to which a report has not been filed under paragraph (a) of this section, whether or not required to be filed thereunder, shall make a report thereof, stating the amount, the date of receipt, the form of monetary instruments, and the person from whom received.

(c) This section shall not require reports by (1) a Federal Reserve bank, (2) a bank, a foreign bank, or a broker or dealer in securities, in respect to currency or other monetary instruments mailed or shipped through the postal service or by common carrier, (3) a commercial bank or trust company organized under the laws of any State or of the United States with respect to overland shipments of currency or monetary instruments shipped to or received from an established customer maintaining a deposit relationship with the bank, in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the business, industry or profession of the customer concerned, (4) a person who is not a citizen or resident of the United States in respect to currency or other monetary instruments mailed or shipped from abroad to a bank or broker or dealer in securities through the postal service or by common carrier, (5) a common carrier of passengers in respect to currency or other monetary instruments in the possession of its passengers, (6) a common carrier of goods in respect to shipments of currency or monetary instruments not declared to be such by the shipper, (7) a travelers' check issuer or its agent in respect to the transportation of travelers' checks prior to their delivery to selling agents for eventual sale to the public, (8) nor by a person engaged as a business in the transportation of currency, monetary instruments and other commercial papers with respect to the transportation of currency or other monetary instruments overland between established offices of banks or brokers or dealers in securities and foreign persons.

(d) This section does not require that more than one report be filed covering a particular transportation, mailing or shipping of currency or other monetary instruments with respect to which a complete and truthful report has been filed by a person. However, no person required by paragraph (a) or (b) of this section to file a report shall be excused from liability for failure to do so if, in fact, a complete and truthful report has not been filed.

§103.24 Reports of foreign financial accounts

Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Secretary for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons. Persons having a financial interest in 25 or more foreign financial accounts need only note that fact on the form. Such persons will be required to provide detailed information concerning each account when so requested by the Secretary or his delegate.

§103.25 Reports of transactions with foreign financial agencies

(a) *Promulgation of reporting requirements.* The Secretary, when he deems appropriate, may promulgate regulations requiring specified financial institutions to file reports of certain transactions with designated foreign financial agencies. If any such regulation is issued as a final rule without notice and opportunity for public comment, then a finding of good cause for dispensing with notice and comment in accordance with 5 USC 553(b) will be included in the regulation. If any such regulation is not published in the *Federal Register*, then any financial institution subject to the regulation will be named and personally served or otherwise given actual notice in accordance with 5 USC 553(b).

(b) *Information subject to reporting requirements.* A regulation promulgated pursuant to paragraph (a) of this section shall designate one or more of the following categories of information to be reported:

(1) Checks or drafts, including traveler's checks, received by respondent financial institution for collection or credit to the account of a foreign financial agency, sent by respondent financial institution to a foreign country for collection or payment, drawn by respondent financial institution on a foreign financial agency, drawn by a foreign financial agency on respondent financial institution—including the following information.

(i) Name of maker or drawer;

(ii) Name of drawee or drawee financial institution;

(iii) Name of payee;

(iv) Date and amount of instrument;

(v) Names of all endorsers.

(2) Wire or electronic fund transfers received by respondent financial institution from a foreign financial agency or sent by respondent financial institution to a foreign financial agency—including the following information:

(i) Name of foreign financial agency;

(ii) Name, address and account number of acount being credited or debited by respondent financial institution;

(iii) Name of respondent financial institution;

(iv) Date and amount of each transfer;

(v) Any other information normally appearing on respondent financial institution's internal wire or electronic fund transfer entries.

(3) Loans made by respondent financial institution to or through a foreign financial agency—including the following information:

(i) Name of borrower;

(ii) Name of person acting for borrower;

(iii) Date and amount of loan;

(iv) Terms of repayment;

(v) Name of guarantor;

(vi) Rate of interest;

(vii) Method of disbursing proceeds;

(viii) Collateral for loan.

(4) Commercial paper received or shipped by the respondent financial institution—including the following information:

(i) Name of maker;

(ii) Date and amount of paper;

(iii) Due date;

(iv) Certificate number;

(v) Amount of transaction.

(5) Stocks received or shipped by respondent financial institution—including the following information:

(i) Name of corporation;

(ii) Type of stock;

(iii) Certificate number;

(iv) Number of shares;

(v) Date of certificate;

(vi) Name of registered holder;

(vii) Amount of transaction.

(6) Bonds received or shipped by respondent financial institution—including the following information:

(i) Name of issuer;

(ii) Bond number;

(iii) Type of bond series;

(iv) Date issued;

(v) Due date;

(vi) Rate of interest;

(vii) Amount of transaction;

(viii) Name of registered holder.

(7) Certificates of deposit received or shipped by respondent financial institution—including the following information:

(i) Name and address of issuer;

(ii) Date issued;

(iii) Dollar amount;

(iv) Name of registered holder;

(v) Due date;

(vi) Rate of interest;

(vii) Certificate of number;

(viii) Name and address of issuing agent.

(c) *Scope of reports.* In issuing regulations as provided in paragraph (a) of this section, the Secretary will prescribe:

(1) A reasonable classification of financial institutions subject to or exempt from a reporting requirement;

(2) A foreign country to which a reporting requirement applies if the Secretary decides that applying the requirement to all foreign countries is unnecessary or undesirable;

(3) The magnitude of transactions subject to a reporting requirement; and

(4) The kind of transaction subject to or exempt from a reporting requirement.

(d) *Form of reports.* Regulations issued pursuant to paragraph (a) of this section may prescribe the manner in which the information is to be reported. However, the Secretary may authorize a designated financial institution to report in a different manner if the institution demonstrates to the Secretary that the form of the required report is unnecessarily burdensome on the institution as prescribed; that a report in a different form will provide all the information the Secretary deems necessary; and that submission of the information in a different manner will not unduly hinder the effective administration of this part.

(e) *Limitations.* (1) In issuing regulations under paragraph (a) of this section, the Secretary shall consider the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency.

(2) The Secretary shall not issue a regulation under paragraph (a) of this section for the purpose of obtaining individually identifiable account information concerning a customer, as defined by the Right to Financial Privacy Act (12 USC 3401 *et seq.*), where that customer is already the subject of an ongoing investigation for possible violation of the Currency and Foreign Transactions Reporting Act, or is known by the Secretary to be the subject of an investigation for possible violation of any other Federal law.

(3) The Secretary shall not issue a regulation pursuant to paragraph (a) of this section requiring a financial institution to report transactions that were both completed and reflected in its records prior to the date it received notice of the reporting requirement.

(Approved by the Office of Management and Budget under Control No. 1505–0063)

§103.26 Filing of reports

(a) A report required to be filed by paragraph (a)(1) or (a)(2) of §103.22 shall be filed within 15 days following the day on which the transaction occurred. The reports shall be filed with the Commissioner of Internal Revenue on forms to be prescribed by the Secretary. All information called for in such forms shall be furnished. A copy of each report shall be retained by the financial institution for a period of five years from the date of the report. (OMB Control number 1505–0087)

(b) Reports required to be filed by §103.23(a) shall be filed at the time of entry into the United States or at the time of departure, mailing or shipping from the United States, unless otherwise directed or permitted by the Commissioner of Customs. They shall be filed with the Customs officer in charge at any Customs port of entry or departure, or as otherwise permitted or directed by the Commissioner of Customs. If the currency or other monetary instruments with respect to which a report is required do not accompany a person entering or departing from the United States, such reports may be filed by mail on or before the date of entry, departure, mailing or shipping, with the Commissioner of Customs, Attention: Currency Transportation Reports, Washington, D.C. 20226. They shall be on forms to be prescribed by the Secretary and all information called for in such forms shall be furnished.

(c) Reports required to be filed by §103.23(b) shall be filed with the Commissioner of Customs within 30 days after receipt of the currency or other monetary instruments. They may be filed with the Customs officer in charge at any port of entry or departure, or by mail addressed to the Commissioner of Customs, Attention: Currency Transportation Reports, Washington, D.C. 20226. They shall be on forms to be prescribed by the Secretary and all information called for in such forms shall be furnished.

(d) Forms to be used in making the reports required by §§103.22 and 103.23 may be obtained from any Internal Revenue office; in addition, forms to be used in making the reports required by §103.23 may be obtained from any office of the Bureau of Customs.

§103.27 Identification required

Before effecting any transaction with respect to which a report is required under paragraph (a) of §103.22, a financial institution shall verify and record the name and address of the individual presenting a transaction, as well as record the identity, account number, and the social security or taxpayer identification number, if any, of any person or entity for whose or which account such transaction is to be effected. Verification of the identity of an individual who indicates that he is an alien or is not a resident of the United States must be made by passport, alien identification card, or other official document evidencing nationality or residence. Verification of identity in any other case may be by examination of a document normally acceptable as a means of identification when cashing checks, for example, a driver's license or a credit card. In each instance, the method used in verifying the identity of the customer shall be recorded on the report.

Subpart C—Records Required To Be Maintained

§103.31 Determination by the Secretary

The Secretary hereby determines that the records required to be kept by this subpart have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.

§103.32 Records to be made and retained by persons having financial interests in foreign financial accounts

Records of accounts required by §103.24 to be reported on a Federal income tax return shall be retained by each person having a financial interest in any such account. Such records shall contain the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period. Such records shall be retained for a period of 5 years and shall be kept at all times available for inspection as authorized by law. In the computation of the period of 5 years, there shall be disregarded any period beginning with a date on which the taxpayer is indicted or information instituted on account of the filing of a false or fraudulent Federal income tax return or failing to file a Federal income tax return, and ending with the date on which final disposition is made of the criminal proceeding.

§103.33 Records to be made and retained by financial institutions

Each financial institution shall retain either the original or a microfilm or other copy or reproduction of each of the following:

(a) A record of each extension of credit in an amount in excess of $5,000, except an extension of credit secured by an interest in real property, which record shall contain the name and address of the person to whom the extension of credit is made, the amount thereof, the nature or purpose thereof, and the date thereof.

(b) A record of each advice, request, or instruction received regarding a transaction which results in the transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account, or place outside the United States.

(c) A record of each advice, request, or instruction given to another financial institution or other person located within or without the United States, regarding a transaction intended to result in the transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account or place outside the United States.

§103.34 Additional records to be made and retained by banks

(a)(1) With respect to each certificate of deposit sold or redeemed after May 31, 1978, or each deposit or share account opened with a bank after June 30, 1972, a bank shall, within 45 days from the date such a transaction occurs or an account is opened, secure and maintain a record of the taxpayer identification number of the customer involved; or where the account or certificate is in the names of two or more persons, the bank shall secure the taxpayer identification number of a person having a financial interest in the certificate or account. In the event that a bank has been unable to secure, within the 45-day period specified, the required identification, it shall nevertheless not be deemed to be in violation of this section if (i) it has made a reasonable effort to secure such identification, and (ii) it maintains a list containing the names, addresses, and account numbers of those persons from whom it has been unable to secure such identification, and makes the names, addresses, and account numbers of those persons available to the Secretary as directed by him. A bank acting as an agent for another person in the purchase or redemption of a certificate of deposit issued by another bank is responsible for obtaining and recording the required taxpayer identification, as well as for maintaining the records referred to in paragraphs (b)(11) and (12) of this section. The issuing bank can satisfy the recordkeeping requirements by recording the name and address of the agent together with a description of the instrument and the date of the transaction.

(2) The 45-day period provided for in paragraph (a)(1) of this section shall be extended where the person opening the account has applied for a taxpayer identification or social security number on Form SS–4 or SS–5, until such time as the person maintaining the account has had a reasonable opportunity to secure such number and furnish it to the bank.

(3) A taxpayer identification number required under paragraph (a)(1) of this section need not be secured for accounts or transactions with the following: (i) Agencies and instrumentalities of Federal, State, local or foreign governments; (ii) judges, public officials, or clerks of courts of record as custodians of funds in controversy or under the control of the court; (iii) aliens who are (A) ambassadors, ministers, career diplomatic or consular officers, or (B) naval, military or other attaches of foreign embassies and legations, and for the members of their immediate families; (iv) aliens who are accredited representatives of international organizations which are entitled to enjoy privileges, exemptions and immunities as an international organization under the International Organization Immunities Act of December 29, 1945 (22 USC sec. 288), and the members of their immediate families; (v) aliens temporarily residing in the United States for a period not to exceed 180 days; (vi) aliens not engaged in a trade or business in the United States who are attending a recognized college or university or any training program, supervised or conducted by any agency of the Federal Government; (vii) unincorporated subordinate units of a tax exempt central organization which are covered by a group exemption letter; (viii) a person under 18 years of age with respect to an account opened as a part of a school thrift savings program, provided the annual interest is less than $10;

(ix) a person opening a Christmas club, vacation club and similar installment savings programs provided the annual interest is less than $10, and (x) non-resident aliens who are not engaged in a trade or business in the United States. In instances described in paragraphs (a)(3), (viii) and (ix) of this section, the bank shall, within 15 days following the end of any calendar year in which the interest accrued in that year is $10 or more use its best effort to secure and maintain the appropriate taxpayer identification number or application form therefore.

(4) The rules and regulations issued by the Internal Revenue Service under section 6109 of the Internal Revenue Code of 1954 shall determine what constitutes a taxpayer identification number and whose number shall be obtained in the case of an account maintained by the one or more persons.

(b) Each bank shall, in addition, retain either the original or a microfilm or other copy or reproduction of each of the following:

(1) Each document granting signature authority over each deposit or share account;

(2) Each statement, ledger card or other record on each deposit or share account, showing each transaction in, or with respect to, that account;

(3) Each check, clean draft, or money order drawn on the bank or issued and payable by it, except those drawn for $100 or less or those drawn on accounts which can be expected to have drawn on them an average of at least 100 checks per month over the calendar year or on each occasion on which such checks are issued, and which are (i) dividend checks, (ii) payroll checks, (iii) employee benefit checks, (iv) insurance claim checks, (v) medical benefit checks, (vi) checks drawn on government agency accounts, (viii) checks drawn by brokers or dealers in securities, (viii) checks drawn on fiduciary accounts, (ix) checks drawn on other financial institutions, or (x) pension or annuity checks;

(4) Each item in excess of $100 (other than bank charges or periodic charges made pursuant to agreement with the customer), comprising a debit to a customer's deposit or share account, not required to be kept, and not specifically exempted, under paragraph (b)(3) of this section;

(5) Each item, including checks, drafts, or transfers of credit, of more than $10,000 remitted or transferred to a person, account or place outside the United States;

(6) A record of each remittance or transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account or place outside the United States;

(7) Each check or draft in an amount in excess of $10,000 drawn on or issued by a foreign bank which the domestic bank has paid or presented to a nonbank drawee for payment;

(8) Each item, including checks, drafts or transfers of credit, of more than $10,000 received directly and not through a domestic financial institution, by letter, cable or any other means, from a bank, broker or dealer in foreign exchange outside the United States;

(9) A record of each receipt of currency, other monetary instruments, investment securities or checks, and of each transfer of funds or credit, of more than $10,000 received on any one occasion directly and not through a domestic financial institution, from a bank, broker or dealer in foreign exchange outside the United States; and

(10) Records prepared or received by a bank in the ordinary course of business, which would be needed to reconstruct a demand deposit account and to trace a check in excess of $100 deposited in such account through its domestic processing system or to supply a description of a deposited check in excess of $100. This subparagraph shall be applicable only with respect to demand deposits.

(11) A record containing the name, address, and taxpayer identification number, if available, of the purchaser of each certificate of deposit, as well as a description of the instrument, a notation of the method of payment, and the date of the transaction.

(12) A record containing the name, address and taxpayer identification number, if available, of any person presenting a certificate of deposit for payment, as well as a description of the instrument and the date of the transaction.

§103.35 Additional records to be made and retained by brokers and dealers in securities

(a)(1) With respect to each brokerage account opened with a broker or dealer in securities after June 30, 1972, by a person residing or doing business in the United States or a citizen of the United States, such broker or dealer shall within 45 days from the date such account is opened, secure and maintain a record of the taxpayer identification number of the person maintaining the account, or in the case of an account of one or more individuals, such broker or dealer shall secure and maintain a record of the social security number of an individual having a financial interest in that account. In the event that a broker or dealer has been unable to secure the identification required within the 45-day period specified, it shall nevertheless not be deemed to be in violation of this section if: (i) It has made a reasonable effort to secure such identification, and (ii) it maintains a list containing the names, addresses, and account numbers of those persons from whom it has been unable to secure such identification, and makes the names, addresses, and account numbers of those persons available to the Secretary as directed by him.

(2) The 45-day period provided for in paragraph (a)(1) of this section shall be extended where the person opening the account has applied for a taxpayer identification or social security number on Form SS–4 or SS–5, until such time as the person maintaining the account has had a reasonable opportunity to secure such number and furnish it to the broker or dealer.

(3) A taxpayer identification number for a deposit or share account required under paragraph (a)(1) of this section need not be secured in the following instances: (i) Accounts for public funds opened by agencies and instrumentalities of Federal, State, local, or foreign governments, (ii) accounts for aliens who are *(a)* ambassadors, ministers, career diplomatic or consular officers, or *(b)* naval, military or other attaches of foreign embassies, and legations, and for the members of their immediate families, (iii) accounts for aliens who are accredited representatives to international organizations which are entitled to enjoy provileges, exemptions, and immunities as an international organization under the International Organizations Immunities Act of December 29, 1945 (22 USC sec. 288), and for the members of their immediate families, (iv) aliens temporarily residing in the United States for a period not to exceed 180 days, (v) aliens not engaged in a trade or business in the United States who are attending a recognized college or university or any training program, supervised or conducted by any agency of the Federal Government, and (vi) unincorporated subordinate units of a tax exempt central organization which are covered by a group exemption letter.

(b) Every broker or dealer in securities shall, in addition, retain either the original or a microfilm or other copy or reproduction of each of the following:

(1) Each document granting signature or trading authority over each customer's account;

(2) Each record described in §240.17a–3(a) (1), (2), (3), (5), (6), (7), (8), and (9) of Title 17, Code of Federal Regulations;

(3) A record of each remittance or transfer of funds, or of currency, checks, other monetary instruments, investment securities, or credit, of more than $10,000 to a person, account, or place, outside the United States;

(4) A record of each receipt of currency, other monetary instruments, checks, or investment securities and of each transfer of funds or credit, of more than $10,000 received on any one occasion directly and not through a domestic financial institution, from any person, account or place outside the United States.

§103.36 Additional records to be made and retained by casinos

(a) With respect to each deposit of funds, account opened or line of credit extended after the effective date of these regulations, a casino shall, at the time the funds are deposited, the account is opened or credit is extended, secure and maintain a record of the social security number of the person involved. Where the deposit, account or credit is in the names of two or more persons, the casino shall secure the social security number of each person having a financial interest in the deposit, account or line of credit. In the event that a casino has been unable to secure the required social security number, it shall not be deemed to be in violation of this section if (1) it has made a reasonable effort to secure such number and (2) it maintains a list containing the names and permanent addresses of those persons from who it has been unable to obtain social security numbers and makes the names and addresses of those persons available to the Secretary upon request.

(b) In addition, each casino shall retain either the original or a microfilm or other copy or reproduction of each of the following:

(1) A record of each receipt (including but not limited to funds for safekeeping or front money) of funds by the casino for the account (credit or deposit) of any person. The record shall include the name, permanent address and social security number of the person from whom the funds were received, as well as the date and amount of the funds received. If the person from whom the funds were received is a non-resident alien, the person's passport number or a description of some other government document used to verify the person's identity shall be obtained and recorded.

(2) A record of each bookkeeping entry comprising a debit or credit to a customer's deposit account or credit account with the casino.

(3) Each statement, ledger card or other record of each deposit account or credit account with the casino, showing each transaction (including deposits, receipts, withdrawals, disbursements or transfers) in or with respect to, a customer's deposit account or credit account with the casino.

(4) A record of each extension of credit in excess of $2,500, the terms and conditions of such extension of credit, and repayments. The record shall include the customer's name, permanent address, social security number, and the date and amount of the transaction (including repayments). If the customer or person for

whom the credit extended is a non-resident alien, his passport number or description of some other government document used to verify his identity shall be obtained and recorded.

(5) A record of each advice, request or instruction received or given by the casino for itself or another person with respect to a transaction involving a person, account or place outside the United States (including but not limited to communications by wire, letter, or telephone). If the transfer outside the United States is on behalf of a third party, the record shall include the third party's name, permanent address, social security number, signature, and the date and amount of the transaction. If the transfer is received from outside the United States on behalf of a third party, the record shall include the third party's name, permanent address, social security number, signature, and the date and amount of the transaction. If the person for whom the transaction is being made is a non-resident alien the record shall also include the person's name, his passport number or a description of some other government document used to verify his identity.

(6) Records prepared or received by the casino in the ordinary course of business which would be needed to reconstruct a person's deposit account or credit account with the casino or to trace a check deposited with the casino through the casino's records to the bank of deposit.

(7) All records, documents or manuals required to be maintained by a casino under state and local laws or regulations. (OMB Control number 1505–0087)

§103.37 Nature or records and retention period

(a) Wherever it is required that there be retained either the original or a microfilm or other copy or reproduction of a check, draft, monetary instrument, investment security, or other similar instrument, there shall be retained a copy of both front and back of each such instrument or document, except that no copy need be retained of the back of any instrument or document which is entirely blank or which contains only standardized printed information, a copy of which is on file.

(b) Records required by this subpart to be retained by financial institutions may be those made in the ordinary course of business by a financial institution. If no record is made in the ordinary course of business of any transaction with respect to which records are required to be retained by this subpart, then such a record shall be prepared in writing by the financial institution.

(c) Records which are required by §103.34(b)(10) to be retained by banks shall be retained for a period of 2 years. All other records which are required by this subpart to be retained by financial institutions shall be retained for a period of 5 years. All such records shall be filed or stored in such a way as to be accessible within a reasonable period of time, taking into consideration the nature of the record, and the amount of time expired since the record was made.

§103.38 Person outside the United States

For the purposes of this subpart, a remittance or transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit to the domestic account of a person whose address is known by the person making the remittance or transfer, to be outside the United States, shall be deemed to be a remittance or transfer to a person outside the United States, except that, unless otherwise directed by the Secretary, this section shall not apply to a transaction on the books of a domestic financial institution involving the account of a customer of such institution whose address is within approximately 50 miles of the location of the institution, or who is known to be temporarily outside the United States.

Subpart D—General Provisions

§103.41 Dollars as including foreign currency

Wherever in this part an amount is stated in dollars, it shall be deemed to mean also the equivalent amount in any foreign currency.

§103.42 Photographic or other reproductions of Government obligations

Nothing herein contained shall require or authorize the microfilming or other reproduction of

(a) Currency or other obligation or security of the United States as defined in 18 USC 8, or

(b) Any obligation or other security of any foreign government, the reproduction of which is prohibited by law.

§103.43 Availability of information

The Secretary may make any information set forth in any report received pursuant to this part available to any other department or agency of the United States upon the request of the head of such department or agency, made in writing and stating the particular information desired, the criminal, tax or regulatory investigation or proceeding in connection with which the information is sought and the official need therefor. Any information made available under this section to other departments or agencies of the United States shall be received by them in confidence, and shall not be disclosed to any person except for official purposes relating to the investigation or proceeding in connection with which the information is sought.

§103.44 Disclosure

All reports required under this part and all records of such reports are specifically exempted from disclosure under section 552 of Title 5, United States Code

§103.45 Exceptions, exemptions, and reports

(a) The Secretary, in his sole discretion, may by written order or authorization make exceptions to or grant exemptions from the requirements of this part Such exceptions or exemptions may be conditional or unconditional may apply to particular persons or to classes of persons, and may apply to particular transactions or classes of transactions. They shall, however, be applicable only as expressly stated in the order of authorization, and they shall be revocable in the sole discretion of the Secretary

(b) The Secretary shall have authority to further define all terms used herein

(c)(1) The Secretary may, as an alternative to the reporting and recordkeeping requirements for casinos in §§103 22(a)(2) and 103 25(a)(2), and 103.36, grant exemptions to the casinos in any state whose regulatory system substantially meets the reporting and recordkeeping requirements of this part

(2) In order for a state regulatory system to qualify for an exemption on behalf of its casinos, the state must provide

(i) That the Treasury Department be allowed to evaluate the effectiveness of the state's regulatory system by periodic oversight review of that system,

(ii) That the reports required under the state's regulatory system be submitted to the Treasury Department within 15 days of receipt by the state

(iii) That any records required to be maintained by the casinos relevant to any matter under this Part and to which the state has access or maintains under its regulatory system be made available to the Treasury Department within 30 days of request

(iv) That the Treasury Department be provided with periodic status reports on the state's compliance efforts and findings,

(v) That all but minor violations of the state requirements be reported to Treasury within 15 days of discovery; and

(vi) That the state will initiate compliance examinations of specific institutions at the request of Treasury within a reasonable time, not to exceed 90 days where appropriate, and will provide reports of these examinations to Treasury within 15 days of completion or periodically during the course of the examination upon the request of the Secretary If for any reason the state were not able to conduct an investigation within a reasonable time, the state will permit Treasury to conduct the investigation

(3) Revocation of any exemption under this subsection shall be in the sole discretion of the Secretary

§103.46 Enforcement

(a) Responsibility for assuring compliance with the requirements of this part is delegated as follows

(1) To the Comptroller of the Currency, with respect to national banks and banks in the District of Columbia

(2) To the Board of Governors of the Federal Reserve System, with respect to State bank members of the Federal Reserve System,

(3) To the Federal Home Loan Bank Board, with respect to insured building and loan associations, insured savings and loan associations, and insured institutions as defined in section 401 of the National Housing Act;

(4) To the Administrator of the National Credit Union Administration, with respect to Federal credit unions,

(5) To the Federal Deposit Insurance Corporation, with respect to all other banks except agents of foreign banks which agents are not supervised by State or Federal bank supervisory authorities.

(6) To the Securities and Exchange Commission, with respect to brokers and dealers in securities.

(7) To the Commissioner of Customs with respect to §§103.23 and 103.48.

(8) To the Commissioner of Internal Revenue except as otherwise specified in this section

(b) Overall responsibility for coordinating the procedures and efforts of the agencies listed herein and assuring compliance with this part is delegated to the Assistant Secretary (Enforcement and Operations) Periodic reports shall be made by each such agency to the Assistant Secretary (Enforcement and Operations), with copies to the General Counsel of the Treasury and to the Commissioner of Internal Revenue

(Sec 21 of the Federal Deposit Insurance Act 84 Stat 1114 12 USC 1829b, 84 Stat 1116, 12 USC 1951–1959 and the Currency and Foreign Transactions Reporting Act 84 Stat 1118 31 USC 1051–1122)

§103.47 Civil penalty

(a) For any willful violation of any requirement of this part, the Secretary may assess upon any domestic financial institution, and upon any partner, director, officer or employee thereof who willfully participates in the violation, a civil penalty not exceeding $10,000

(b) For any failure to file a report required under §103.23 or for filing such a report containing any material omission or misstatement, the Secretary may assess a civil penalty up to the amount of the currency or monetary instruments transported, mailed or shipped, less any amount forfeited under §103.48.

§103.48 Forfeiture of currency or monetary instruments

Any currency or other monetary instruments which are in the process of any transportation with respect to which a report is required under §103.23 are subject to seizure and forfeiture to the United States if such report has not been filed as required in §103.25, or contains material omissions or misstatements. The Secretary may, in his sole discretion, remit or mitigate any such forfeiture in whole or in part upon such terms and conditions as he deems reasonable.

§103.49 Criminal penalty

(a) Any person who willfully violates any provision of title I of Pub. L. 91–508, or of this part authorized thereby may, upon conviction thereof, be fined not more than $1,000 or be imprisoned not more than 1 year, or both. Such person may in addition, if the violation is of any provision authorized by title I of Pub. L. 91–508 and if the violation is committed in furtherance of the commission of any violation of Federal law punishable by imprisonment for more than 1 year, be fined not more than $10,000 or be imprisoned not more than 5 years, or both.

(b) Any person who willfully violates any provision of title II of Pub. L. 91–508, or of this part authorized thereby, may, upon conviction thereof, be fined not more than $250,000 or be imprisoned not more than 5 years, or both.

(c) Any person who willfully violates any provision of title II of Pub. L. 91–508, or of this part authorized thereby, where the violation is either:

(1) Committed in furtherance of the commission of any other violation of Federal law, or

(2) Committed as part of a pattern of illegal activity involving transactions exceeding $100,000 in any 12-month period, may, upon conviction thereof, be fined not more than $500,000 or be imprisoned not more than 5 years, or both.

(d) Any person who knowingly makes any false, fictitious or fraudulent statement or representation in any report required by this part may, upon conviction thereof, be fined not more than $10,000 or be imprisoned not more than 5 years, or both.

§103.50 Enforcement authority with respect to transportation of currency or monetary instruments

(a) If a customs officer has reasonable cause to believe that there is a monetary instrument being transported without the filing of the report required by §§103.23 and 103.25 of this chapter, he may stop and search, without a search warrant, a vehicle, vessel, aircraft, or other conveyance, envelope or other container, or person entering or departing from the United States with respect to which or whom the officer reasonably believes is transporting such instrument.

(b) If the Secretary has reason to believe that currency or monetary instruments are in the process of transportation and with respect to which a report required under §103.23 has not been filed or contains material omissions or misstatements, he may apply to any court of competent jurisdiction for a search warrant. Upon a showing of probable cause, the court may issue a warrant authorizing the search of any or all of the following:

(1) One or more designated persons.

(2) One or more designated or described places or premises.

(3) One or more designated or described letters, parcels, packages, or other physical objects.

(4) One or more designated or described vehicles. Any application for a search warrant pursuant to this section shall be accompanied by allegations of fact supporting the application.

(c) This section is not in derogation of the authority of the Secretary under any other law or regulation.

§103.51 Access to records

Except as provided in §§103.34(a)(1), 103.35(a)(1), and 103.36(a) and except for the purpose of assuring compliance with the recordkeeping and reporting requirements of this part, this part does not authorize the Secretary or any other person to inspect or review the records required to be maintained by Subpart C of this part. Other inspection, review or access to such records is governed by other applicable law.

§103.52 Rewards for informants

(a) If an individual provides original information which leads to a recovery of a criminal fine, civil penalty, or forfeiture, which exceeds $50,000, for a violation of the provisions of the Act or of this part, the Secretary may pay a reward to that individual.

(b) The Secretary shall determine the amount of the reward to be paid under this section; however, any reward paid may not be more than 25 percent of the net amount of the fine, penalty or forfeiture collected, or $150,000, whichever is less.

(c) An officer or employee of the United States, a State, or a local government who provides original information described in paragraph (a) in the performance of official duties is not eligible for a reward under this section.

APPENDIX—INTERPRETATIONS AND EXEMPTIONS

The following interpretations and exemptions were compiled in response to requests by persons subject to the regulations of Part 103. Additional interpretations and exemptions will appear from time to time as the occasion warrants. Identifying details and confidential information have been deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements concerning disclosure of information obtained from members of the public.

Section 103.11 *Exemption from* 1. The definition of a bank as appears in §103.11(a)(7) was not intended to include a company which is wholly engaged in financing inventories and retail installment sales of automobile dealers. Such a company requested and was granted an exemption from the recordkeeping and reporting requirements of Part 103, Title 31, Code of Federal Regulations. However, if said company is a "financial institution" within the meaning of §103.11 (other than as a "bank") it would, of course, have to comply with those provisions of this part relating to financial institutions other than banks.

Section 103.23 *Interpretations* 1. Unless a transaction in foreign currency for clients who are nonresidents of the United States and performed through brokers outside the United States involves the physical transportation, mailing, or shipment of currency, bearer investment securities or negotiable instruments in bearer form into or out of the United States in amounts exceeding $5,000 on any one occasion, there is no duty to report the transfer. A transfer of funds by means of bank check, bank draft, or wire transfer need not be reported.

2. A bank is not required to prepare Form 4790 if the bank receives such items over the counter from a person who may have transported them into the United States or if the bank delivers such items over the counter to a person who may transport them out of the United States. However, if a bank knows that such items have been transported into the country, it must file a report on Form 4790 if a complete and truthful report has not been filed by the customer.

3. Section 103.23(c) provides that a bank is not required to report currency or other monetary instruments mailed or shipped through the postal service or by common carrier. When a trust company is acting as a corporate executor or corporate trustee, no report need be filed with respect to currency or bearer monetary instruments mailed or shipped through the postal service.

4. In the case where a trust company acts as custodian for individual executors and trustees who maintain custody accounts for those estates and trusts where they are named fiduciary, it will be necessary to file a Form 4790, Report of International Transportation of Currency or Monetary Instruments, under the circumstances described in §103.23(a).

5. A private courier service does not qualify as a "common carrier" under the regulations.

Section 103.23 *Exemptions from* 1. A bank whose employees physically transport currency across the Canadian border on a weekly basis for deposit with a Canadian bank which is only a few hundred yards away requested an exemption from the requirements of §103.23. Due to the special circumstances, the Department granted the request provided that an accurate record of such transfers is maintained by the bank.

2. A bank in Maine, which for a period of more than 20 years, has used its personnel to physically transport sums of currency and checks in excess of $5,000 to and from a bank in a contiguous Canadian town several times a month, requested and was granted an exemption from the reporting requirements of §103.23 due to the special circumstances involved. The Department, however, does require the bank to maintain an accurate account of such transfers.

3. An exemption is granted to any merchant shipping company from the requirement to report the transportation into or out of the United States of currency or bearer instruments in amounts in excess of $5,000 with respect to currency or bearer instruments placed on board ship by the owner or operator in order to provide for reasonable shipping needs. Records of such moneys placed on board are to be maintained by the shipping companies.

4. A company that transports sealed packages containing money and valuables under written bilateral contracts for banks, brokerage houses, and security dealers requested an exemption from the requirements of this section. Under the provisions of §103.23(c)(7), such companies are exempt from reporting the transportation of currency or monetary instruments overland between established offices of banks or brokers or dealers in securities and foreign banks. The company in question is further granted an exemption from reporting overland shipments between domestic banks, brokers, or security dealers and foreign persons. However, all firms engaged in international

carriage of valuables by air must continue to file with the Bureau of Customs reports of international air shipments.

Section 103.24 *Interpretation*. Treasury announced on March 20, 1978, that an officer or employee of a domestic corporation, which has securities listed on national securities exchanges or which has assets exceeding $1 million and 500 or more shareholders of record, need not report that he has signature authority over a foreign financial account of the corporation, provided he has no personal financial interest in the account and has been advised in writing by the chief financial officer of the corporation that the corporation has filed a current report which includes that account.

Treasury subsequently received a request for an interpretation regarding the ruling's applicability to officers and employees of domestic subsidiaries of such corporations.

Since the March 20 notice permits a parent corporation to file a consolidated report of foreign financial accounts on behalf of itself and any other entity in which it owns directly or indirectly more than a 50 percent interest, we see no reason to discriminate between employees of the parent and those of its subsidiaries.

Accordingly, an officer or employee of a domestic subsidiary of a domestic corporation which has securities listed on national securities exchanges or which has assets exceeding $1 million and 500 or more shareholders of record, need not report that he has signature authority over a foreign financial account of the subsidiary, if he has no personal financial interest in the account and has been advised in writing by the chief financial officer of the parent corporation that the subsidiary corporation has filed a current report which includes that account.

Section 103.33(a) *Interpretation*. 1. This regulation requires the keeping of records, the majority of which are already kept by financial institutions. The typical loan application form asks the applicant to state the purpose of the loan, so it would seem normal in the case of each extension of credit in an amount in excess of $5,000 for the record to contain a reference to the nature or the purpose of the loan. However, if it is a passbook loan, for example, the entry "passbook loan" would suffice.

Section 103.34(a) *Interpretations*. 1. Any citizen residing or doing business in the United States and any citizen of the United States who opens an account with a financial institution after June 30, 1972, must provide that institution with his taxpayer identification number at the time the account is opened. For individuals, the taxpayer identification number is his social security number, for corporations, partnerships, and other entities, it is the IRS employer identification number. Banks, savings and loan associations, building and loan associations, savings banks, credit unions, and brokers and dealers in securities are included in this requirement. If an account is opened in more than one individual's name, the financial institution is required to secure and maintain the social security number of at least one individual having a financial interest in that account.

If the customer does not have a taxpayer identification number or has lost his card and is unaware of his number, the account may be opened provided the customer (or if under 18 years of age, his guardian) authorizes the Social Security Administration to furnish his social security number to both the customer and the financial institution, or the customer, regardless of age, authorizes the Internal Revenue Service to furnish his employer identification number to both the customer and the financial institution.

With respect to accounts opened for trusts, charitable organizations, clubs, and similar entities the financial institution should secure the employer identification number of the entity. An employer identification number must be obtained for this purpose even though an organization might not otherwise require one. See instructions published July 6, 1972 (37 FR 13279).

2. This requirement of a taxpayer identification number does not apply to aliens who are ambassadors, ministers, career diplomatic or consular officers, or to naval, military and other attachés of foreign embassies and legations, and the members of their immediate families, nor to aliens who are accredited representatives to international organizations entitled to enjoy privileges, exemptions, and immunities as an international organization under the International Organizations Immunities Act of December 29, 1945 (22 USC 288), and the members of their immediate families.

3. In regard to determining the proper identifying number to be furnished by accounts opened in more than one name, the bank should follow the regulations and rulings issued by the Internal Revenue Service under section 6109 of the Internal Revenue Code. These rules are outlined on the back of IRS Form 3435. However, the bank should not use Form 3435 to apply for a taxpayer identification number for a new account, but should instead use Form SS–4 or SS–5.

4. The bankruptcy estate of an individual or partnership is considered as a separate entity from the individual or partnership. However, the Treasury Department does not regard the estate of a corporation in bankruptcy as an entity separate from the corporation. Accordingly, the trustee of a corporation in bankruptcy should use the identification number of the corporation. Upon completion of the IRS Form SS–4 with an appropriate authorization to furnish the employer

identification number to the institution, a trustee will be permitted to make deposits He need not wait until the employer identification number is obtained

5 All accounts that are primarily savings or checking accounts, with the exception of mortgage escrow accounts, are deposit accounts and are subject to the requirements of this section.

6 Where a person purchases a money order directly from the bank or through an agent of the bank and the bank maintains only a consolidated account with no separate record by customer, no deposit account has been opened by the customer and only those recordkeeping requirements normally applicable to cashier's checks would apply.

7. Where a person reopens a checking account after June 30, 1972, the bank is required to secure the social security number just as with a new account, and the same would apply to the automatic extension of a certificate of deposit.

8 [Reserved]

9 A credit card program operated by a bank does not involve a deposit account and is not, therefore, subject to the requirements of this section.

10 Section 103.34(a) exempts nonresident aliens not doing business in the United States from the requirement to furnish the bank with a taxpayer identification number. If an alien asserts that he is neither residing nor doing business in the United States a bank therefor may open the account without obtaining a taxpayer identification number, provided that it secures a statement from the person to that effect and provided the bank is unaware of any facts inconsistent with that statement. Normal banking practices for ascertaining identity and location of customers should be followed. All nonresident aliens in the United States should have one of the following U.S. Immigration and Naturalization Service forms:

1. Form I–151 (Alien Registration Receipt Card).
2. Form I–185 (Nonresident Alien Canadian Border Crossing Card).
3. Form I–186 (Nonresident Alien Mexican Border Crossing Card).
4. Form I–94 (Arrival-Departure Record)
5. Form I–95A (Alien Crewman's Landing Permit).
6. Form I–184 (Alien Crewman's Landing Permit and Identification Card).

The bank should maintain a record of the applicant's country of citizenship and the number assigned him on his INS form or other official document issued by the applicant's government.

11 In regard to a business firm opening an account in the name of employees who are foreign nationals not residing in the United States, the bank may open the account for them without securing a taxpayer identification number pursuant to this section provided that the bank is satisfied that the persons are nonresident aliens not doing business in the United States The bank should verify the identity and whereabouts of such persons and require the business firm to supply for each such account a statement to the effect that the employee is a nonresident alien not doing business in the United States.

12. It is acknowledged that the "Old Order Amish" people do not accept social security benefits or pay self-employment tax. In 1965, the Internal Revenue Code was amended to provide an exemption from self-employment tax if a person can show that he is a member of a recognized religious sect which follows the practice of making reasonable provisions for its dependent members. While the Amish people are opposed to and exempted from the social security program, they do pay their Federal taxes. A bank should explain to its Amish customers that the number required to open any account is merely a taxpayer identification number and in no way obligates such persons to the social security system. However, if a depositor still objects on religious grounds to applying for a social security number, Form SS–4, Application for an Employer Identification Number, can be used instead.

13. If a new business has applied for an employer identification number, but has not yet received it when it seeks to open a bank account, the bank may open the account if it secures a completed Form SS–4 in accordance with the instructions issued by Treasury. The completed Form should not be sent to IRS but simply retained as evidence that an application for a number is pending. Since in the above instance the bank will not automatically receive the number, it must follow up with the customer to insure that the number is furnished within a reasonable time. Generally speaking, the Internal Revenue Service furnishes an employer identification number to an applicant within 45 days

Section 103.34(a) *Exemptions from.* 1. An exemption from the requirements of this subsection is granted with respect to all accounts opened as part of a school savings program for school savers up to 18 years of age, provided that the amount of interest earned on such accounts is $10 or less. Children over 18 years of age may apply for a social security number without parental authorization and payments of interest aggregating $10 or more are required by section 6049, Internal Revenue Code of 1954, to be reported on Form 1099, together with the depositor's social security number. Banks having a school savings program should set up appropriate procedures to obtain numbers for accounts helo by persons aged 18 years or older and for all accounts earning interest of $10 or more annually. 2. An exemption from the requirements of this subsection is granted with respect to Christmas Club accounts, provided the annual interest is not anticipated to exceed $10.

Section 103.34(b) *Interpretations.* 1. If there is no check or draft corresponding to a preauthorized paper entry, it will be sufficient to maintain the customer's authorization to charge his account and the memorandum list of entries for a period of 5 years.

2. Insurance companies commonly issue drafts in settlement of claims or for other purposes which are payable through a particular bank, but which are drawn on the company itself and not on a deposit account. However, drafts which are issued by insurance companies are treated as checks throughout the financial system, despite the fact that they are not drawn on a deposit account, and are, therefore, subject to the requirements of §103.34(b) (3). If these drafts meet the volume and purpose requirements of this section, no copy need be retained. If they do not meet these standards, it will be necessary for the bank to retain a copy of the draft as required by this section and to retain the records required by §103.34(b) (10) for a period of 2 years.

3. Clean drafts, including "cash item drafts", are drawn "payable through" or "payable at" a particular bank. The bank receives them and presents them to its customer who reviews them and pays for those it accepts. The majority of such items should be eligible for exemption under §103.34(b) (3), those which are not eligible should be microfilmed or copied before they are released to the customer.

4. Section 103.34(b) (10) does not require a receiving bank to copy or be able to produce an item drawn on another bank. Furthermore, a bank need not be able to supply a description of a deposited check if it can trace a check through its domestic processing system.

Section 103.36 *Interpretation.* 1. A bank must retain for a period of 5 years checks drawn on itself. However, the proof and entry run tapes, which allow a bank to reconstruct an account, need only be retained for a period of 2 years.

Section 103.37 *Interpretation.* 1. The term "temporarily" used in this section should be interpreted as a vacation or business assignment expected to last less than 6 months.

Section 103.42 *Interpretation.* 1. This section provides that nothing contained herein shall require or authorize the microfilming or other reproduction of currency or obligation or security of the United States as defined in 18 USC 8 or any obligation or security of any foreign government. However, government checks may be microfilmed, but not copied, for the purpose of tracing or identifying a transaction.

Section 103.45 *Exemptions.* 1. A bank, whose employees physically transport currency across the Canadian border on a weekly basis for deposit with a Canadian bank which is only a few hundred yards away, requested an exemption from the requirements of §103.23. Due to the special circumstances, the Department granted the request provided that an accurate record of such transfers is maintained by the bank.

2. A bank in Maine, which for a period of more than 20 years has used its personnel to physically transport sums of currency and checks in excess of $5,000 to and from a bank in a contiguous Canadian town several times a month, requested and was granted an exemption from the reporting requirements of §103.23 due to the special circumstances involved. The Department, however, does require the bank to maintain an accurate record of such transfers.

3. An exemption is granted to any merchant shipping company from the requirement to report the transportation into or out of the United States of currency or bearer instruments in amounts in excess of $5,000 with respect to currency or bearer instruments placed on board ship by the owner or operator in order to provide for reasonable shipping needs. Records of such monies placed on board are to be maintained by the shipping companies.

4. A company wholly engaged in financing inventories and retail installment sales of automobile dealers which came within the definition of a "bank" in §103.11(a) (7) requested and was granted an exemption from the recordkeeping and reporting requirements of Part 103, Title 31, Code of Federal Regulations. However, if said company is a "financial institution" within the meaning of §103.11 (other than as a "bank") it would, of course, have to comply with those provisions of this part relating to financial institutions other than banks.

5. An exemption from the requirements of §103.34(a) is granted with respect to all accounts opened as part of a school savings program for school savers up to 18 years of age, provided that the amount of interest earned on such accounts is $10 or less. Children over 18 years of age may apply for a social security number without parental authorization and payments of interest aggregating $10 or more are required by section 6049, Internal Revenue Code of 1954, to be reported on Form 1099, together with the depositor's social security number. Banks having a school savings program should set up appropriate procedures to obtain numbers for accounts held by persons aged 18 years

or older and for all accounts earning interest of $10 or more annually.

6. An exemption from the provisions of Part 103, Title 31, Code of Federal Regulations, is granted to those persons who are registered with the Securities and Exchange Commission as broker-dealers solely in order to offer and sell variable annuity contracts issued by life insurance companies. However, if a person so registered at any time offers and sells other types of securities in addition to variable annuity contracts, this exemption does not apply to any part of his business. This exemption will in no way affect recordkeeping regulations or other requirements promulgated under the Securities and Exchange Act of 1934, as amended.

7. An exemption from the requirements of §103.34(a) is granted with respect to Christmas Club accounts, provided the annual interest is not anticipated to exceed $10.

BC - 193

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Financial Recordkeeping and Reporting of Currency and Foreig Transactions Act, 31 CFR 103

TO: Chief Executive Officers of all National Banks, Officers in Charge of Federal Branches and Agencies, Deputy Comptrollers (District), District Administrators, Department and Division Heads, and all Examining Personnel.

PURPOSE

The purpose of this issuance is to remind bank management of its ongoing responsibility to ensure compliance with all aspects of the Bank Secrecy Act.

REFERENCE

- Banking Circular #49 and Supplement No. 5.
- Banking Bulletins 80-18 and 83-8.

BACKGROUND

There is recent evidence of a lack of compliance with the Bank Secrecy Act by certain members of the banking industry. Particular areas of concern include:

- the detailed completion and proper filing of Form 4789 for currency transactions in excess of $10,000 with foreign banks and Form 4790 for transportation of currency in excess of $10,000 to or from the United States. (The filing of Form 4790 does not eliminate the need for filing Form 4789 and vice versa.);
- the required filing of Form 4789 for cash purchases of checks/money orders/securities/etc, currency exchanges or other cash transactions. (The exemption list provisions apply only to deposits and/or withdrawals by an established depositor who is a United States resident and all transactions with government agencies or instrumentalities.);
- the compilation and maintenance of a centralized, current and accurate list with appropriate information of established deposit customers whose deposits and withdrawals are permitted to be exempt from reporting requirements;

BEST COPY AVAILABLE

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BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

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Subject: Financial Recordkeeping and Reporting of Currency and Foreig Transactions Act, 31 CFR 103

- o the legality and reasonableness of the customers contained on the exemption list. Attention should be directed to 31 CFR 103.22 which lists specific types of businesses that qualify for exemption; and,
- o the filing of written reports of potential violations of criminal law as required under Interpretive Ruling 7.5225.

With regard to the second bullet point above, a new method of laundering drug money has recently been detected. Groups of "runners" are dispatched to a given geographical area and are directed to buy cashiers checks, official checks, money orders, etc. in amounts less than $10,000 from numerous offices of financial institutions and other issuers of monetary instruments. These items are then combined into one deposit at another financial institution, possibly controlled by the drug trafficker. Bankers should be alert to this type of scheme.

REQUIREMENTS

If it has not already been done, management of each national bank, or Federal branch or agency should establish and enforce policies and operating procedures to ensure compliance with all aspects of the Bank Secrecy Act. The following should be considered:

- o require centralized control and review of the BSA compliance function;
- o encourage the reporting of unusual or suspicious purchases of cashiers checks, etc. by non-customers;
- o verify the identity of non-customers purchasing such items from identity cards with pictures; and,
- o encourage the reporting of suspicious large deposits consisting of numerous and/or out-of-area items.

The procedures, staff awareness, and operations should be tested on a regular basis by the bank's internal/external auditors, or by management personnel not directly involved in this area of operation. Methods to accomplish this should be documented and contained in the Internal Audit Program. In addition, the

Date: April 24, 1985

management, staff and auditors responsible for compliance with the BSA should be provided training to ensure their knowledge of the detailed requirements of the law.

If and when violations come to the attention of management, the violations should be discussed with the Department of Treasury, and the applicable OCC District office should be notified of such discussions. In addition, banks are reminded that these violations be reported in accordance with requirements of Interpretive Ruling 7.5225.

Failure to comply with the law can result in assessment of substantial criminal and/or civil penalties.

For further information on the Bank Secrecy Act, the amendments or interpretations of the provisions, please contact the Office of the Chief National Bank Examiner at the number listed below.

ORIGINATING OFFICE

Chief National Bank Examiner, Commercial Examinations Division, (202) 447-1164.

H. Joe Selby
Senior Deputy Comptroller
for Bank Supervision

Attachment: 31 CFR 103

BC - 193
SUPPLEMENT 1

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, 31 CFR 103

TO: Chief Executive Officers of all National Banks, Officers in Charge of Federal Branches and Agencies, Deputy Comptrollers (District), District Administrators, Department and Division Heads, and all Examining Personnel

This Office has received numerous inquiries regarding the applicability of the filing requirements of 31 C.F.R. 103.23 (Form 4790) where a bank hires a private courier service to effect the international transportation of currency through a common carrier. In a recent response to one such inquiry, the Department of Treasury advised:

- Under 31 C.F.R. 103.23(c), a bank is not required to file a Form 4790 in respect to currency or other monetary instruments mailed or shipped through the postal service or by common carrier.

- This exemption applies to those situations where the bank ships such currency directly through the common carrier as well as in those instances where a bank utilizes a private courier service to deliver such currency from the bank to the common carrier and international shipment of such currency is made via such common carrier.

- The reporting provisions of 31 C.F.R. 103.22, which require the filing of Form 4789 for all currency transactions in excess of $10,000, unless exempted by regulation, are still applicable to these international transactions, however.

- This exemption applies to banks only and does not affect the reporting responsibilities of either the private courier service or the common carrier.

Attached is a copy of the recent opinion issued by Treasury on this subject.

Michael Pa

Michael Patriarca
Deputy Comptroller
of the Currency

Date May 9, 1985

Page 1 **of** 1

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

APR 03 1985

Dear

This is in response to your letter dated February 14, 1985, to Mr. Robert Stankey, in which you question whether (the Bank) is required to file Form 4790's reporting the international transportation of currency in the circumstances set out in your letter. The issue presented by your inquiry is whether 31 C.F.R. 103.23(c)(2) exempts the Bank from the filing requirement when it hires private couriers to effect the international transportation of currency and the couriers ship the currency by regularly scheduled commercial airlines.

The salient facts, as described in your letter, indicate that you regularly ship currency to your [foreign] branch and an unaffiliated bank in [foreign country] To effect these shipments you retain a private courier service that transports the currency from your cash vault to an international airport, where it is placed on regularly scheduled commercial airlines. An employee of the courier service presents appropriate documentation evidencing a shipment of the currency and accompanies the shipment as a passenger of the airline.

The Currency and Foreign Transaction Reporting Act, 31 U.S.C. 5316, provides that any person who exports more than $10,000 in currency must file a report with the appropriate Customs officer at the time of entry, departure, mailing or shipping to or from the United States, unless otherwise directed. 31 C.F.R. 103.23(a), 103.25(b). The Secretary is authorized and has prescribed exemptions to the filing requirements. 31 U.S.C. 5318; 31 C.F.R. 103.23(c),(d). Transactions by "a bank . . . in respect to currency . . . mailed or shipped through the postal service or by common carrier" are exempt from the reporting requirements. 31 C.F.R. 103.23(c)(2).

Based on the facts as stated in your letter, it appears that: (1) is a bank; (2) the documentation accompanying the currency establishes that it was shipped; and (3) common carriers (regularly scheduled commercial airlines) were used to effect the shipments. Accordingly, the exemption in 31 C.F.R. 103.23(c)(2) applies to these transactions.

I hope this information will be helpful to you. If you have any questions or need further assistance, you may contact Robert J. Stankey, (202) 566-8022.

Sincerely,

David D. Queen

David D. Queen
Deputy Assistant Secretary
(Enforcement)

BC- 193
supp. #2

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, 31 CFR 103

TO: Chief Executive Officers of all National Banks, Officers in Charge of Federal Branches and Agencies, Deputy Comptrollers (District), District Administrators, Department and Division Heads, and all Examining Personnel.

We have been informed by the Internal Revenue Service of the following change. Effective immediately:

> IRS FORM 4789, CURRENCY TRANSACTION REPORTS; and, TREASURY FORM 90-22.1, REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS are to be filed at the following address:

IRS Data Center
P.O. Box 32621
Detroit, Michigan 48232

Attn: CTR Processing .or.
FBAR Processing

All questions regarding this change should be addressed to:

Mr. Billy U. Landreth
Bank Secrecy Act Compliance Specialist
Department of the Treasury
15th and Pennsylvania Avenue, N. W.
Washington, D. C. 20220
(202-566-5630)

Please eliminate all references to the former Ogden, Utah mailing address from your records.

ORIGINATING OFFICE

Office of the Chief National Bank Examiner, Commercial Examinations Division, (202) 447-1164.

John F. Downey

John F. Downey
Chief National Bank Examiner

Date: July 5, 1985

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BC-193
(Supp. 3)

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Financial Recordkeeping and Report of Currency and Foreign Transactions Act, 31 CFR 103

TO: Chief Executive Officers of all National Banks, Officers in Charge of Federal Branches and Agencies, Deputy Comptrollers (District), District Administrators, Department and Division Heads, and all Examining Personnel

PURPOSE

The purpose of this issuance is to update Banking Circular 193 and provide information regarding 31 CFR 103 responsibilities delegated to the Internal Revenue Service (IRS).

REFERENCE

Banking Circular 193, dated April 24, 1985, includes a revised copy of 31 CFR 103. Several amendments to the regulation have been promulgated since this circular was issued. The Comptroller's Manual for National Banks was amended in July, 1985 to reflect these changes. As such, the copy of 31 CFR 103 supplied with BC-193 should be discarded.

Delegations to the Internal Revenue Service

The Department of the Treasury delegated increased reponsibilities to IRS. This delegation is effective January 1, 1986. The noteworthy changes are:

- IRS is responsible for reviewing the 31 CFR 103 exemption lists maintained by financial institutions;
- approval or denial of individual requests for exemptions from the reporting requirements are sent to IRS; and
- IRS is authorized to begin investigations for possible criminal violations of 31 CFR 103.

A copy of the December 27, 1985 press release is attached.

John F. Downey
John F. Downey
Chief National Bank Examiner

Attachment

Date January 27, 1986

Page 1 of 1

News Release

Department of the Treasury
Internal Revenue Service
Public Affairs Division
Washington, DC 20224

Media Contact: Tel. (202) 566-4024
Copies: Tel. (202) 566-4054

For Release: 12/27/85

IR-85-125

Washington--In a move designed to increase its effectiveness in combatting illegal money laundering, the Internal Revenue Service today said it will assume responsibility on Jan. 1, 1986, for reviewing exemption lists of financial institutions, as well as approving or denying individual requests for exemption from the currency transactions reporting requirements of the Bank Secrecy Act.

The increased authority under the Bank Secrecy Act was delegated to the IRS by the Department of the Treasury.

The IRS also said it is authorized to begin investigations of banks and brokers or dealers in securities for possible criminal violations of the Bank Secrecy Act. In addition, the IRS now has responsibility to assure that all banks not now examined by federal bank supervisory agencies for safety and soundness are in compliance with the currency transaction reporting requirements.

Filings of currency transaction reports almost tripled during 1985 -- from an average of 60,000 per month to more than 170,000, the IRS said. Explaining the increase, the IRS credited the strong enforcement of the Bank Secrecy laws, expecially in some well publicized cases in the recent past.

The IRS will request from banks and other financial institutions the list of their customers who have been granted exemption from the reporting requirements. It will review these lists and direct the institutions to remove the names of customers with unacceptable exemptions and to file currency transaction reports on those customers.

(More)

The IRS noted that the delegation of exemption authority is not exclusive and that authority for resolving interpretative matters will remain with the Secretary of the Treasury.

Banks and similar financial institutions should address requests for exemptions to the Internal Revenue Service, P.O. Box 32063, Detroit MI 48232.

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BC - 193
Supp. #4

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Financial Recordkeeping and Reporting of Currency and Forei
Transactions Act, 31 CFR 103

TO: Chief Executive Officers of all National Banks, Officers in Charge of Federal Branches and Agencies, Deputy Comptrollers (District), District Administrators, Department and Division Heads, and all Examining Personnel

The Internal Revenue Service is receiving numerous questions regarding requests for exemptions from the reporting requirements of 31 CFR 103. Most of the questions relate to background information necessary to support the request for exemption. Accordingly, IRS furnished the attached "Guidelines for Requesting Special Exemptions From the Financial Reporting Requirements of CFR 31, Part 103."

John F. Downey
John F. Downey
Chief National Bank Examiner

Attachment

Date March 27, 1986

Page 1 of 1

Guidelines For Requesting Special Exemptions From the Financial Reporting Requirements of CFR 31, Part 103

A bank may apply to the IRS for authority to grant an exemption to the reporting requirements, not otherwise provided for under paragraph (b) of CFR 31 Part 103.22, if the bank believes that circumstances warrant such an exemption. Such requests should be addressed to:

Exemption Staff
Currency and Banking Reports Division
Internal Revenue Service
Post Office Box 32063
Detroit, Michigan 48232

A written request, signed by an official of the bank, should include the following information about the customer.

1. Name, address, and Federal taxpayer identification number (nine digits) of the customer.
2. Description of customer's business.
3. Whether the exemption would cover deposits or withdrawals, or both.
4. A listing of daily amounts of currency deposited during a recent 2-month period.
5. A listing of daily amounts of currency withdrawn during a recent 2-month period.
6. Ordinarily, what percentage of the amount of the withdrawals is in $100 bills?
7. Amount of maximum limit for the requested exemption.

In addition, the request should include the name and telephone number of the bank official to call in regards to the exemption request.

BC- 207

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Standard Criminal Referral Form

To: Chief Executive Officers of all National Banks; All State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; Deputy Comptrollers (Districts); District Administrators; District Counsel and Examining Personnel

Use of OCC Forms CC-8010-09 and CC-8010-08

Attached for your reference are copies of OCC Form No. CC-8010-09, Criminal Referral Form (Long Form), and OCC Form No. CC-8010-08, Criminal Referral Form (Short Form). Effective immediately, these forms are to be used by banks and examiners to report all known or suspected crimes involving the affairs of a national bank. Please note that the forms refer to 12 C.F.R. §21.11. This is a new section to the Code of Federal Regulations which has been proposed for adoption by the Office of the Comptroller of the Currency (OCC). This new section would supersede the requirements contained in 12 C.F.R. §7.5225 which address the circumstances under which national banks are currently required to report known or suspected crimes.

The attached criminal referral forms issued by the OCC are similar to forms being issued for use by the other Federal financial institutions regulatory agencies. These forms were designed by the Department of Justice-Interagency Task Force, which was created in 1984 to improve the detection, investigation, and prosecution of bank fraud cases. On April 2, 1985, the participants in that Task Force, known also as the Attorney General's Bank Fraud Working Group, signed a series of agreements and recommendations to serve the purposes set out above. (See Banking Bulletin 85-5, issued April 2, 1985.)

Date September 18, 1985

BC - 207

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Standard Criminal Referral Form

One of the recommendations of that group was to develop a standard form for reporting crimes involving financial institutions. The attached forms will be used by all national banks seeking to report suspected crimes involving the banks or individuals associated with the banks. The requirement that the form be used is not intended to preclude the use of the telephone or other means to expedite referrals, however, the form should be filed either at the same time or subsequent to such reports. The forms are self-contained and complete with instructions as to the information which must be provided. Specific questions regarding the forms and their use should be directed to the District Counsel serving the District in which the bank is located. Additional copies of the form may be reproduced locally or requested through the OCC's Communications Division, Washington, D.C. 20219.

Also attached for your information is a copy of the proposed rule as it appeared in the Federal Register on August 28, 1985. Comments must be received on or before October 28, 1985.

H. Joe Selby
Acting Comptroller of
the Currency

Date September 18, 1985

[illegible]
Expires 7/31/88

Control No. (Agency Use Only)

CRIMINAL REFERRAL FORM
(LONG FORM)

Comptroller of the Currency
Administrator of National Banks

Banks are required by 12 C.F.R. §21.11 to report known or suspected crimes involving the affairs of the bank. A report is required in case of:

- **any known or suspected theft, embezzlement, check kiting operation, misapplication, or other defalcation involving bank funds or bank personnel in any amount.**
- **any known or suspected criminal violation of any section of the United States Code or applicable state statutes involving the affairs of the bank.**
- **any mysterious disappearance or unexplained shortage of bank funds or other assets of $1,000 or more which is not located by the bank within seven business days.**

Use this form in all cases where suspected criminal activity involves probable loss (before reimbursement or recovery) of $10,000 or greater and in all cases, regardless of amount, involving an executive officer, director or principal shareholder of the institution within the meaning of 12 C.F.R. §215. This form should be filed by the bank no later than seven business days following discovery of the suspected violation.

Robberies, burglaries, and nonemployee larcenies should be reported to the appropriate law enforcement agencies. Filing of this form is not required. See 12 C.F.R. §21.5(c).

The purpose of this form is to provide a consistent means by which financial institutions can make referrals of known or suspected criminal activity perpetrated against the institutions whether by insiders or those outside the institution. The form will provide an effective means by which appropriate law enforcement and supervisory authorities will be made aware of known or suspected criminal activity. Institutions should use care in filling out this form and should insure that it is filled out in as complete a manner as practicable under the circumstances.

Paperwork Reduction Act Notice
Criminal Referral Form

[illegible]

1 Name, Location and Charter Number of Financial Institution

NAME ______________________________

LOCATION ____________ ____________ ____ ____________
STREET CITY ST ZIP

CHARTER NUMBER __________ If activity occurred at branch office(s) please identify ____________________

2 Asset Size of Financial Institution (millions of dollars) __________

3 Approximate date and dollar amount (prior to any allowance for restitution or recovery) of suspected violation

DATE __________ AMOUNT (thousands of dollars) __________
Month Day Year

4 Summary characterization of the suspected violation. Check appropriate box(es)

☐ Defalcation/Embezzlement
☐ False Statement
☐ Check Kiting
☐ Bribery/Gratuity
☐ Misuse of Position or Self Dealing
☐ Mysterious Disappearance
☐ Other (Describe) ____________________

Applicable Section(s) of Title 18 U.S. Code (if known) (See list on page 7) ____________________

CC 8[illegible]

5 This matter is being referred to the FBI (or the IRS in cases involving 31 C.F.R. §103) in ______ ______
CITY ST

and the U.S. Attorney in ______ ______ ______
CITY ST JUDICIAL DISTRICT (if known)

6 Person(s) Suspected of Criminal Violation. Complete subparagraphs (a) through (e) for each individual suspected of criminal activity (if more than one, use continuation sheet). Include primary suspects only. Individuals who may have knowledge of the suspected criminal activity but who are not themselves suspected of being involved should be listed as witnesses under Item 10. Provide any additional details known with respect to prior referrals or affiliations.

a NAME ______ ______ ______
FIRST MI LAST

ADDRESS ______ ______ ______ ______
STREET CITY ST ZIP

DATE OF BIRTH ______ SOCIAL SECURITY NO. ______
(if known) Month Day Year (if known)

b Relationship to the financial institution (check all applicable boxes)
☐ Officer ☐ Employee ☐ Broker ☐ Shareholder
☐ Director ☐ Agent ☐ Borrower ☐ Other Specify ______

c Is person still affiliated with the financial institution ☐ Yes ☐ No

If no ☐ terminated ☐ resigned DATE ______
Month Day Year

Describe Circumstances (if necessary, use continuation sheet) ______

d Prior or related referrals ☐ Yes ☐ No If yes, please identify

e Is person affiliated with any other financial institution ☐ Yes ☐ No or business enterprise ☐ Yes ☐ No If yes, either or both, please identify

7 a Explanation/Description of Suspected Violation. Provide a **brief** narrative description of the activity giving rise to the referral, explaining what is unusual or irregular about the transaction. Details will be provided later in the form. The purpose of this paragraph is to provide a **summary** description of the overall transaction.

b. Give a chronological and complete account of the suspected violation. (Use continuation sheet if necessary.)

- Relate key events to documents and attach copies of those documents.
- Explain who benefited, financially or otherwise, from the transaction, how much, and how.
- Furnish any explanation of the transaction provided by the suspect and indicate to whom and when it was given.
- Furnish any explanation of the transaction provided by any other person.
- Furnish any evidence of cover up by the suspect or evidence of an attempt to deceive federal or state examiners or others.
- Indicate where the suspected violation took place (e.g., main office, branch, other).
- Recommend any further investigation that might assist law enforcement in fully examining the potential violation.

THIS SECTION OF THE REFERRAL IS CRITICAL. It should be as complete as circumstances permit. The care with which this section is written may make the difference in whether or not the described conduct and its criminal nature are clearly understood. The discussion points listed in this section are not exhaustive. They should be covered but to the extent additional explanation would be useful as to any particular item or to the event an additional category should be discussed, it should be done here. Feel free to use attachments or to continue the description on a separate sheet. Include any suggestions for the interviewing of any witnesses, gathering of any documents or methods of investigation which might prove useful in following up on the referral (e.g., tracing of proceeds).

c Indicate whether the suspected violation appears to be an isolated incident or whether it relates to other transactions (Explain)

8 Exclusion of Information from the Referral
Has any pertinent information been excluded from this referral as a result of any legal or other restraint? ☐ Yes ☐ No
If so why? ______________________________
____
Have the excluded information or documents been segregated for later retrieval? ☐ Yes ☐ No

9 Has there been a confession? ☐ Yes ☐ No If so by whom? ______________________________

10 Witnesses
List any witnesses who might have information about the suspected violation and describe their position or employment. Indicate if they have been interviewed (Use continuation sheet if necessary)

	Name	Position	Address	Tele	Interviewed	
					Yes	No
1					☐	☐
2					☐	☐
3					☐	☐
4					☐	☐
5					☐	☐

11 Discovery and Reporting
a Who discovered the suspected violation and when?

b Has the suspected violation been reported to the Board of Directors? ☐ Yes ☐ No By whom and when?

c Has the Board of Directors taken action? ☐ Yes ☐ No If so what and when?

d Has the suspected violation previously been reported to federal or local law enforcement or to any federal or state supervisory agency? ☐ Yes ☐ No If so by whom to whom and when?

12 Loss
- a Amount of loss known $ ______
- b Restitution by ______
  In the amount of $ ______
- c Name of Applicable Surety Bond Company ______
- d Amount of Bond $ ______
- e Amount of deductible $ ______
- f Was claim filed? ☐ Yes ☐ No
- g Settlement by Surety Company $ ______
- h Total restitution and settlement to date $ ______
- i Net loss (after subtracting any amounts paid in the form of restitution or settlement) $ ______
- j Is additional loss suspected? ☐ Yes ☐ No (If yes, explain)

- k Has the suspected violation had a material impact on or otherwise effected the financial soundness of the institution? If so, please explain

13 Offer of Assistance

The individuals listed below are/will be authorized to discuss this referral with appropriate law enforcement officials and to assist in locating or explaining any documents pertinent to this referral, **provided that contact is first made with**

Name ______ Position ______
Phone No ______

Name ______ Tele. No ______
Name ______ Tele. No ______
Name ______ Tele. No ______

14 Form Prepared by ______ ______
Position ______
Agency/Institution ______
Phone No ______ Date ______

DISTRIBUTION
If Referral Is Made by Bank:

1 Retain one copy in the bank's files.
2 Send one copy to District Administrator, Office of the Comptroller of the Currency
3 (a) Send one copy to the nearest office of the FBI, or
  (b) If the referral is related to 31 C.F.R. 103, send one copy to the Criminal Investigation unit of the nearest office of the IRS
4 Send one copy to nearest office of the U.S. Attorney

DISTRIBUTION BY EXAMINER/DISTRICT COUNSEL
If Referral Is Made by Examiner:

Examiner
1 Retain one copy in work papers
2 (a) Community bank—send one copy to field office
  (b) All other banks—send one copy to District Office ATTENTION: District Counsel

District
3 Retain one copy in District Office under name of the bank
4 Send one copy to the Director, Enforcement and Compliance Division, OCC, Washington, DC 20219, accompanied by a cover letter signed by the District Counsel, indicating, in appropriate cases, the priority to be given the referral
5 (a) Send one copy to the nearest office of the FBI, or
  (b) If the referral is related to 31 C.F.R. 103, send one copy to the Criminal Investigation unit of the nearest office of the IRS
6 Send one copy to the U.S. Attorney. If also a criminal violation of state law, consider sending the referral to the appropriate state prosecuting authority

CONTINUATION SHEET

Item No	Remarks

INSTRUCTIONS FOR EXAMINERS

Examiners should fill out this form whenever suspected criminal activity has been independently discovered by the examiner and not reported by the institution or the referral made by the institution is deemed to be inadequate. It is important to note that this form should be filled out whenever criminal activity is suspected; examiners are not required to make any initial finding that such referrals would, if pursued, result in a criminal conviction. That judgment will be made by responsible law enforcement authorities. Any questions regarding whether or not any particular activity would constitute a crime for purposes of making a criminal referral should be resolved through communications with District Counsel.

The purpose of this referral is to provide appropriate law enforcement authorities with complete and accurate information relating to suspected criminal activity. All information requested within the body of the form should be supplied at the time of the referral unless such information is not known or can only be supplied at a later date by operation of The Right to Financial Privacy Act. In the latter case, documents not provided with this form should be segregated and safeguarded in order that they might be subsequently supplied in accordance with the provisions of The Right to Financial Privacy Act. In filling out this form, examiners should avoid overly technical descriptions of transactions which might not be readily understood by law enforcement authorities unfamiliar with banking operations.

CRIMINAL STATUTES

18 U.S.C. 2	To aid, abet, counsel, command, induce or procure, the commission of federal offense.
18 U.S.C. 201	Bribery of public officials, including elected representatives, jurors and employees of any department or agency of the federal government and witnesses in official proceedings, e.g., anyone who gives, offers or promises anything of value to a public official or a witness with the intent to influence that person's official functions.
18 U.S.C. 215	Kickbacks, bribes. Makes it unlawful for any officer, director, employee, agent or attorney to solicit, accept or give anything of value in connection with any transaction or business of any financial institution.
18 U.S.C. 371	Conspiracy of two or more persons to either commit a federal offense or to defraud the United States (or any agency of the U.S.).
18 U.S.C. 656	Theft, embezzlement or misapplication of bank funds, willfully by an officer, director, agent or employee of a bank, with intent to injure or defraud the bank. Can infer intent to injure from the fact of injury or from acts knowingly done in reckless disregard for the interests of the bank.
18 U.S.C. 709	False advertising or misuse of words "National," "Federal Reserve," "Deposit Insurance," etc., to convey impression of federal agency affiliation.
18 U.S.C. 1001	General false statements statute - knowingly and willfully falsifying or concealing a material fact or making a false statement or making or using false writing knowing it to be false.
18 U.S.C. 1005	False entries and reports or statements, including material omissions, with intent to injure or defraud the bank, the OCC (or Fed or FDIC) bank examiners or other individuals or companies.
18 U.S.C. 1014	False statement (oral or written) e.g., loan application, made knowingly for the purpose of influencing any bank whose deposits are federally insured, upon any application, purchase, agreement, commitment, loan (or any change or extension of same) including willfully overvaluing land, property or security.
18 U.S.C. 1029	Credit Card fraud - knowingly and with intent to defraud, produce, use or traffic in counterfeit access devices.
18 U.S.C. 1030	Computer fraud - knowingly accessing a computer without authorization, or using it for unauthorized purposes, including obtaining information contained in records of financial institutions.
18 U.S.C. 1341	Mail fraud - scheme or artifice to defraud that makes use of the Postal Service.
18 U.S.C. 1343	Wire fraud - scheme or artifice to defraud using transmission by wire, radio or TV for the purpose of carrying out the scheme.
18 U.S.C. 1344	Bank fraud - scheme or artifice to defraud a federally insured institution or take money, funds, credits, assets, securities or other property by misrepresentation.
18 U.S.C. 1621	Perjury/false statement made under oath (if false statement is not made under oath, individual may still be prosecuted under 18 U.S.C. 1001 or 1014).
18 U.S.C. 1961 **18 U.S.C. 1962**	Racketeer Influenced and Corrupt Organizations ("RICO") statutes. Investing in any enterprise affecting interstate commerce if the funds for the investment are derived from "a pattern of racketeering activity" (these activities are defined to include: murder, drug dealing, bribery, robbery, extortion, counterfeiting, mail fraud, wire fraud, embezzlement from pension funds, obstruction of criminal investigations, fraud in the sale of securities, etc.).
31 U.S.C. 5311 **31 C.F.R. 103**	Bank Secrecy Act/31 C.F.R. 103 reporting and recordkeeping violations.
S.C. 78dd	Foreign Corrupt Practices Act of 1977. Payment of anything of value to any foreign official, foreign political party or candidate or "any other person where the American corporation knows or has reason to know the thing of value would be offered to a foreign official, foreign political party or candidate for foreign political office."
15 U.S.C. 78ff	Criminal violations of securities laws.
15 U.S.C. 78x	Criminal penalty provisions of securities laws.

OCC District Offices

Northeastern District
1211 Avenue of the Americas
Suite 4250
New York, NY 10036
212 944 3495

Southeastern District
Peachtree Cain Tower
Suite 2700
229 Peachtree St., N.E.
Atlanta, GA 30303
404 221-4926

Central District
Sears Tower
Suite 5750
233 South Wacker Dr.
Chicago, IL 60606
312 353-0300

Midwestern District
2345 Grand Avenue
Suite 700
Kansas City, MO 64108
816-556-1800

Southwestern District
1201 Elm St.
Suite 3800
Dallas, TX 75270
214 767-4400

Western District
50 Fremont Street
Suite 3900
San Francisco, CA 94105
415 545-5900

1557-0069
Expires 7/31/88

______
Control No (Agency Use Only)

CRIMINAL REFERRAL FORM
(SHORT FORM)

Comptroller of the Currency
Administrator of National Banks

Banks are required by 12 C.F.R. §21.11 to report known or suspected crimes involving the affairs of the Bank. A report is required in case of:

- **any known or suspected theft, embezzlement, check kiting operation, misapplication, or other defalcation involving bank funds or bank personnel in any amount.**
- **any known or suspected criminal violation of any section of the United States Code or applicable state statutes involving the affairs of the bank.**
- **any mysterious disappearance or unexplained shortage of bank funds or other assets of $1,000 or more which is not located by the bank within seven business days.**

Use this form only if suspected criminal activity involves actual or probable loss or mysterious disappearances of less than $10,000 (before any recovery or reimbursement) not involving an executive officer, director or principal shareholder of the institution within the meaning of 12 C.F.R. §215. All other referrals should be submitted on OCC Form CC-8010-88, Criminal Referral Form [Long Form]. This form should be filed by the bank no later than seven business days following discovery of the suspected violation.

Robberies, burglaries, and nonemployee larcenies should be reported to the appropriate law enforcement agencies. Filing of this form is not required. See 12 C.F.R. §21.5(c).

1. Name Location and Charter Number of Financial Institution

NAME ______

LOCATION ______ STREET ______ CITY ______ ST ______ ZIP

CHARTER NUMBER ______ If activity occurred at branch office(s) please identify ______

2. Asset Size of Financial Institution (millions of dollars) ______

3. Approximate date and dollar amount of suspected violation

DATE ______ Month Day Year AMOUNT (thousands of dollars) ______

4. Summary characterization of the suspected violation. Check appropriate box(es)

☐ Defalcation/Embezzlement
☐ False Statement
☐ Check Kiting
☐ Bribery/Gratuity
☐ Misuse of Position or Self Dealing
☐ Mysterious Disappearance
☐ Other (Describe) ______

Applicable Section(s) of Title 18, U.S. Code (if known) (See list on page 4) ______

5. This matter is being referred to the FBI (or the IRS in cases involving 31 C.F.R. §103) in ______ CITY ______ ST

and the U.S. Attorney in ______ CITY ______ ST ______ JUDICIAL DISTRICT (if known)

6. Person(s) Suspected of Criminal Violation (if more than one, use continuation sheet)

a. NAME ______ FIRST ______ MI ______ LAST

ADDRESS ______ STREET ______ CITY ______ ST ______ ZIP

DATE OF BIRTH (if known) ______ Month Day Year SOCIAL SECURITY NO (if known) ______

CC 8010 08

b Relationship to the financial institution (check all applicable blocks)
☐ Officer ☐ Employee ☐ Broker ☐ Shareholder
☐ Director ☐ Agent ☐ Borrower ☐ Other Specify ______

c Is person still affiliated with the financial institution ☐ Yes ☐ No

If no ☐ terminated ☐ resigned DATE ______
Month Day Year

Describe Circumstances (if necessary use continuation sheet) ______

d Prior or related referrals ☐ Yes ☐ No If yes please identify

e Is person affiliated with any other financial institution ☐ Yes ☐ No or business enterprise ☐ Yes ☐ No If yes to either or both please identify

7 Explanation/Description of Suspected Violation (Give brief summary of the suspected violation explaining what is unusual or irregular about the transaction. (If necessary, use continuation sheet.)

8 Has there been a confession? ☐ Yes ☐ No If so by whom? ______

9 Offer of Assistance
The individuals listed below are/will be authorized to discuss this referral with appropriate law enforcement officials and to assist in locating or explaining any documents pertinent to the referral, provided that contact is first made with
Name ______ Position ______
Phone No ______

Name ______ Tele No ______
Name ______ Tele No ______
Name ______ Tele No ______

10 Form Prepared by ______
Position ______
Agency/Institution ______
Phone No ______ Date ______

DISTRIBUTION:
If Made By Financial Institution

1 Retain one copy in bank's files.
2 Send one copy to District Administrator, Office of the Comptroller of the Currency
3 (a) Send one copy to the nearest office of the FBI, or
(b) If the referral is related to 31 C.F.R. 103, send one copy to the Criminal Investigation unit of the nearest office of the IRS.
4 Send one copy to the nearest office of the U.S. Attorney

DISTRIBUTION BY EXAMINER/DISTRICT
If Made By OCC

Examiner
1 Retain one copy in work papers.
2 (a) Community bank—send one copy to field office
(b) All other banks—send one copy to District Office. ATTENTION: District Counsel.

District Office
3 Retain one copy in District Office under name of the institution.
4 (a) Send one copy to the nearest office of the FBI, or
(b) If the referral is related to 31 C.F.R. 103, send one copy to the Criminal Investigation unit of the nearest office of the IRS.
5 Send one copy to the nearest office of the U.S. Attorney. If also a criminal violation of state law, consider sending the referral to the appropriate state prosecuting authority.

CONTINUATION SHEET

Item No	Remarks

CRIMINAL STATUTES

18 U.S.C. 2	To aid, abet, counsel, command, induce or procure the commission of federal offense.
18 U.S.C. 201	Bribery of public officials including elected representatives, jurors and employees of any department or agency of the federal government, and witnesses in official proceedings, e.g., anyone who gives, offers or promises anything of value to a public official or a witness with the intent to influence that person's official functions.
18 U.S.C. 215	Kickbacks/Bribery. Makes it unlawful for any officer, director, employee, agent or attorney, to solicit, accept or give anything of value in connection with any transaction or business of any financial institution.
18 U.S.C. 371	Conspiracy of two or more persons to either commit a federal offense or to defraud the United States (or any agency of the U.S.)
18 U.S.C. 656	Theft, embezzlement or misapplication of bank funds willfully by an officer, director, agent or employee of a bank, with intent to injure or defraud the bank. (Can infer intent to injure from the fact of injury, or from acts knowingly done in reckless disregard for the interests of the bank.)
18 U.S.C. 709	False advertising or misuse of words "National," "Federal Reserve," "Deposit Insurance," etc., to convey impression of federal agency affiliation.
18 U.S.C. 1001	General false statements statute - knowingly and willfully falsifying or concealing a material fact or making a false statement or making or using false writing knowing it to be false.
18 U.S.C. 1005	False entries and reports or statements, including material omissions, with intent to injure or defraud the bank, the OCC (or Fed or FDIC), bank examiners or other individuals or companies.
18 U.S.C. 1014	False statement (oral or written) (e.g., loan application) made knowingly for the purpose of influencing any bank whose deposits are federally insured upon any application, purchase agreement, commitment, loan (or any change or extension of same) including willfully overvaluing land, property or security.
18 U.S.C. 1029	Credit Card fraud - knowingly and with intent to defraud, produce, use or traffic in counterfeit access devices.
18 U.S.C. 1030	Computer fraud - knowingly accessing a computer without authorization, or using it for unauthorized purposes, including obtaining information contained in records of financial institutions.
18 U.S.C. 1341	Mail fraud - scheme or artifice to defraud that makes use of the Postal Service.
18 U.S.C. 1343	Wire fraud - scheme or artifice to defraud using transmission by wire, radio or TV for the purpose of carrying out the scheme.
18 U.S.C. 1344	Bank fraud - scheme or artifice to defraud a federally insured institution or take money, funds, credits, assets, securities or other property by misrepresentation.
18 U.S.C. 1621	Perjury/false statement made under oath (if false statement is not made under oath, individual may still be prosecuted under 18 U.S.C. 1001 or 1014).
18 U.S.C. 1961 **18 U.S.C. 1961**	Racketeer Influenced and Corrupt Organizations (RICO) statutes. Investing in any enterprise affecting interstate commerce if the funds for the investment are derived from a pattern of racketeering activity. (These activities are defined to include murder, drug dealing, bribery, robbery, extortion, counterfeiting, mail fraud, wire fraud, embezzlement from pension funds, obstruction of criminal investigations, fraud in the sale of securities, etc.)
31 U.S.C. 5311 **31 C.F.R. 103**	Bank Secrecy Act/31 C.F.R. 103 reporting and recordkeeping violations.
15 U.S.C. 78dd	Foreign Corrupt Practices Act of 1977. Payment of anything of value to any foreign official, foreign political party or candidate or any other person where the American corporation knows or has reason to know the thing of value would be offered to a foreign official, foreign political party or candidate for foreign political office.
15 U.S.C. 78ff	Criminal violations of securities laws.
15 U.S.C. 77x	Criminal penalty provisions of securities laws.

Paperwork Reduction Act Notice
Criminal Referral Form

The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us. We ask for the information to carry out our supervisory responsibilities for national banks. We need it to monitor crimes involving national banks, to evaluate losses and evaluate a bank's internal controls. You are required by 12 C.F.R. §21.11 to give us this information.

OCC District Offices

Northeastern District
1211 Avenue of the Americas
Suite 4250
New York, NY 10036
212-944-3495

Southeastern District
Peachtree Cain Tower
Suite 2700
229 Peachtree St., N.E.
Atlanta, GA 30303
404-[illegible]-4926

Central District
Sears Tower
Suite 5750
233 South Wacker Dr
Chicago, IL 60606
312-353-0300

Midwestern District
2345 Grand Avenue
Suite 700
Kansas City, MO 64108
816-556-1800

Southwestern District
1201 Elm St
Suite 3800
Dallas, TX 75270
214-767-4400

Western District
50 Fremont Street
Suite 3900
San Francisco, CA 94105
415-545-5900

BC - 171
SUPPLEMENT #19

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: North Western Bank of Commerce, Ltd.
Majuro, Marshall Islands 96960

This Office has received information that certain direct obligations on the subject entity may be worthless and that this entity may be operating illegally in the United States. Any information which you may have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division (202-447-1818)
Office of the Comptroller of the Currency
Washington, D.C. 20219

C. T. Conover
C. T. Conover
Comptroller of the Currency

Date: January 3, 1985

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BC- 171
SUPPLEMENT #20

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circuler   Subject Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: BANK OF INDUSTRY AND COMMERCE
P.O. Box 1, Marine Drive
Plymouth, Montserrat, West Indies

This Office has received information that certain direct obligations on the subject entity may be worthless. Extreme caution is recommended. Any information which you may have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division (202-447-1818)
Office of the Comptroller of the Currency
Washington, D.C. 20219

C. T. Conover
C. T. Conover
Comptroller of the Currency

Date January 3, 1985   Page 1 of 1

BC. 171

SUPPLEMENT #21

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular
Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: MULTIBANK
Majuro, Marshall Islands 96960

This Office has received information that certain direct obligations on the subject entity are worthless. Furthermore, we have been informed by the government of the Republic of the Marshall Islands that the subject entity application for a bank license was not processed, therefore was not registered. Any information which you may have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division (202-447-1818)
Office of the Comptroller of the Currency
Washington, D.C. 20219

C. T. Conover
C. T. Conover
Comptroller of the Currency

Date: January 3, 1985

Page 1 of 1

BC-171
SUPPLEMENT #22

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: Pacific Commerce Bank, Ltd.
Majuro, Marshall Islands 96960

This Office has received information that certain direct obligations on the subject entity may be worthless and that this entity may be operating illegally in the United States. Any information which you may have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division (202-447-1818)
Office of the Comptroller of the Currency
Washington, D.C. 20219

C. T. Conover
C. T. Conover
Comptroller of the Currency

Date: January 3, 1985

Page 1 of 1

BC-171
Supplement #23

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Offshore Banks

TO: Chief Executive Officers of National Banks: all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: Republic Overseas Bank, Ltd.; Majuro, Marshall Islands
c/o I.M.A.C., P.O. Box 7040, Reno, Nevada 89510-7040
c/o I.M.A.C., 1325 Airmotive Way, Suite 200, Reno, Nevada 89502

This Office has received information that the subject entity is conducting banking business in the United States illegally. Any information which you have regarding this entity should be brought to the attention of:

Enforcement & Compliance Division
Comptroller of the Currency
Washington, D.C. 20219

C.T. Conover
C. T. Conover
Comptroller of the Currency

Date March 12, 1985

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BC- 171
SUPPLEMENT #24

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: EUROPEAN OVERSEAS BANK LIMITED
P.O. Box 726
MAJURO, MARSHALL ISLANDS 96960
and
1901 Avenue of the Stars, Suite 1774
Los Angeles, California 90067

This Office has received information that the subject entity may be operating illegally in the United States. Any information which you have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division (202-447-1818)
Office of the Comptroller of the Currency
Washington, D.C. 20219

C.T. Conover
C.T. Conover
Comptroller of the Currency

Date March 12, 1985

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BC- 171
Supplement #25

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular   Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: First Colonial Bank, Ltd.
Majuro, Marshall Islands 96960

This Office has received information that certain direct obligations on the subject entity have not been honored and that this entity may be operating illegally in the United States. Any information which you may have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

H. Joe Selby
Acting Comptroller
of the Currency

Date: May 28, 1985

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BC-171 Supp 26

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: Security Development Bank, Ltd.
Majuro, Marshall Islands 96960

This Office has received information that certain direct obligations on the subject entity may be worthless and that this entity may be operating illegally in the United States. Any information which you may have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

H. Joe Selby
H. Joe Selby
Acting Comptroller
of the Currency

Date August 13, 1985

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BC- 171
SUPPLEMENT #27

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

Offshore bank licenses registered by governments of various island countries, notably in the Caribbean and Pacific areas, often have names either identical or very similar to names of well-established commercial banks operating world-wide. Such banks do not have copyright protection of their names in many overseas jurisdictions. As a result, the banking public may be misled as to the actual identity of the named bank. In certain instances, it has been disclosed that a shell bank owner/operator has benefitted from this confusion.

A recent example of such identical names is the HERITAGE INTERNATIONAL BANK. We have been advised by the Heritage International Bank, which is headquartered in Bethesda, Maryland, that this bank has no presence in Plymouth, Montserrat, West Indies, where an offshore shell bank license is registered in the name of Heritage International Bank, Ltd.

Please be guided accordingly. Any questions regarding this matter should be directed to the Enforcement and Compliance Division, Washington, D.C. 20219.

H. Joe Selby
Acting Comptroller of the Currency

Date: 9-12-85

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BC - 171
SUPPLEMENT 28

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: Liberty Bank International or Liberty International Bank
Cayman Islands

This Office has been advised by the Office of the Inspector of Banks of the Cayman Islands that an entity known as LIBERTY BANK INTERNATIONAL or LIBERTY INTERNATIONAL BANK using the Cayman Islands as the source of registration is not registered nor has any official recognition by the Government of the Cayman Islands. Any information which you may have concerning this matter should be brought to the attention of the Enforcement and Compliance Division.

Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

Robert L. Clarke
Comptroller of the Currency

Date December 12, 1985

Page 1 of 1

BC- 171
Supplement 29

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: BANKING SUPPLEMENT

Subject: OFFSHORE SHELL BANKS

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

This Office has been informed by the government of the Cook Islands that the B Class Offshore Banking License, Midland International Bank and Trust Limited, issued December 2, 1985, has been suspended, and that Samir Bashout, the registered holder of this license, is not an official representative of the government of the Cook Islands on Cook Islands banking matters in the United States.

Please be guided accordingly. Any information which you have regarding the above should be brought to the attention of the Enforcement and Compliance Division, Washington, D.C. 20219.

Robert L. Clarke
Comptroller of the Currency

Date: February 25, 1986

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BC- 171
Supplement 30

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: GIBRALTAR INTERNATIONAL BANK, LTD.
MAJURO, MARSHALL ISLANDS 96960

This Office has received information that certain direct obligations on the subject entity may be worthless and that this entity may be operating illegally in the United States. Further, we have been informed that the license has been struck from the registry of the government of the Marshall Islands. Any information which you have regarding the above should be brought to the attention of:

Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219.

Robert L. Clarke
Comptroller of the Currency

Date: February 25, 1986

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BC- 171
Supplement 31

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: INTERNATIONAL BANK OF THE SOUTH PACIFIC
P.O. BOX 4101
NUKU'ALOFA, TONGA

This Office has received information that the subject entity may be operating illegally in the United States. Any information which you may have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219.

Robert L. Clarke
Comptroller of the Currency

Date: March 6, 1986

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BC- 171
Supplement #32

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: Offshore Shell BAnk Licenses Issued by the Government of Saint Vincent, West Indies

This Office has been informed recently by the Government of Saint Vincent, West Indies, that the licenses of the following banks were cancelled by December 31, 1985.

Atlantic Pacific National Bank and Trust Company, Ltd.
Kingstown International Bank, Ltd.
European Overseas Bank, Ltd.
Petrochemical International Bank and Trust, Ltd.
United States Estate Bank, Ltd.
Hamilton Bank and Trust, Ltd.
Inter Commerce Bank, Ltd.
Wagner Distributing, Ltd.
Biomedical Investments, Ltd.
Designconoult Services, Ltd.
Martin Reddington and Lee, Ltd.
Istvanja, Ltd.
Pan Music, Ltd.
Murtal, Ltd.
RJS International Steel Consultants Inc., Ltd.
Riposa Company, Ltd.
Delma International, Ltd.
Trajalgar Finance, Ltd.
Gibraltar Finance, Ltd.
Winchester, Ltd.
Jablanica, Ltd.
Morey-Makers, Ltd.
Joint-Stock, Ltd.
Security Insurance Company, Ltd.
Worldwide Patent Development Company, Ltd.

Date:

BC- 171
Supplement 32

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Offshore Shell Banks

Apparel Contractors, Ltd.
Ikon Investment, Ltd.
Heritage Trust, Ltd.
Spectrum Trading Company, Ltd.
Patagonia Investors International, Ltd.
Bancroft Associates, Ltd.
Business Consultants International, Ltd.
Kog Steward, Ltd.
J.M.P. Insurance System, Ltd.
Omnicorn, Ltd.
Bonneville Associates, Ltd.
Valt International, Ltd.
Weatherhill Resources, Ltd.
Bullion Management Corporation
Commander Investment Trust, Ltd.
Chartered Gold Corporation, Ltd.
British International Reinsurance Company, Ltd.
Simon Investment, Ltd.
Lexington Investment Company, Ltd.
Bootes, Ltd.
Procyon, Ltd.
Mediaezio Group, Ltd.
Solum Societas, Ltd.
Opaz, Ltd.
Clariden Investments, Ltd.
Costraax Venture, Ltd.
Windward Management and Consultancy, Ltd.
Windward Music Production and Disco, Ltd.
Geneva Indemnity, Ltd.
Orion, Ltd.
Gem, Ltd.

Please be guided accordingly. Any information which you may have concerning these entities should be brought to the attention of:

Enforcement & Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

Robert L. Clarke
Comptroller of the Currency

Date: March 6, 1986

Page 2 of 2

BEST [illegible]

BC - 171 # 33

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: Consolidated Bank & Trust Company (W.I.), Limited
68 The Valley
Anguilla, West Indies

This Office has received information that certain direct obligations on the subject entity may be worthless. Extreme caution is recommended. Any information which you may have regarding the subject should be brought to the attention of:

Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219.

Robert L. Clarke
Comptroller of the Currency

Date: MARCH 6, 1986

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BC- 171
Supplement #33a

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular   Subject: Offshore Shell Banks

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

RE: Consolidated Bank & Trust Company (W.I.), Ltd.
68 The Valley
Anguilla, West Indies

We have been advised by CONSOLIDATED BANK, N.A., headquartered 900 West 49th Street, Hialeah, Florida, that it is neither connected, associated nor related in any way to the offshore bank Consolidated Bank & Trust Company (W.I.), Ltd., 68 The Valley, Anguilla, West Indies as cited in BC-171, #33 under the date of March 6, 1986.

Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

Robert L. Clarke
Comptroller of the Currency

Date: March 28, 1986

BC - 141

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Brokered Funds

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; Regional Administrators; Examining Personnel

This Office has been advised on numerous occasions of widespread solicitation by persons who purportedly have access to multi-millions of dollars readily available for loans and deposits in United States financial institutions. Rates and terms quoted, for the most part, are more favorable than for funds obtainable from normal sources. This Office has reason to believe that many such solicitations are not backed by any assured source of funds and that such contacts are for the purpose of involving a financial institution in an "advance fee scheme" either as a victim or to give credibility to the perpetrators. In some instances, solicitations cite that "the program is sanctioned by the State Department and the Federal Home Loan Bank." We have been advised that no such authorizations have been obtained. In such schemes, the "broker" promises large amounts of monies from unidentified sources which, in many cases, are purportedly located in foreign countries.

Banks may be requested to pay "upfront fees." Banks may likewise become involved by acknowledging solicitations in writing or by telex messages or by sending letters on bank stationery. The solicitors may use such responses to give credence to their operations in order to obtain an "upfront fee" from someone else.

It is recognized that some such brokers may be innocent of any such inappropriate activities; nevertheless, banks are advised to view all solicitations with extreme caution. Any questionable contacts should be reported to:

Robert B. Serino, Director
Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

John G. Heimann
Comptroller of the Currency

Date May 2, 1980

Page 1 of 1

BC - 141
SUPPLEMENT 1

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Brokered Funds

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; Regional Administrators; Examining Personnel

This Office has issued banking notices over the years which cite the hazards involved relative to negotiations with persons who purport to have access to multimillions of dollars for placement in the United States. Banking Circular #141, dated May 2, 1980, cautioned the financial community about this problem. Inquiries about the propriety of such proposed transactions have increased substantially.

Recent solicitations from "brokers" contain the same basic elements as in the past. Banks and their trust departments have been requested to act in either a fiduciary capacity or as an escrow agent to receive large placement funds from unidentified sources, many of which purport to originate outside of the United States. The purpose of many is to generate responses reflecting credibility of a transaction or entity. Rates and terms are quoted which are considerably more favorable than for funds obtainable from normal sources.

Frequently, written responses are requested on a suggested format to be placed on official bank stationery or in the bank's telex messages. Some solicitation packages include documents to be signed committing the recipient either to pay upfront fees or to fund commissions through "emissions." Some United States banks have advised that their banks have been named in solicitations without their knowledge or authorization.

Date October 9, 1981

BC - 141
SUPPLEMENT 1

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Brokered Funds

In every known instance brought to the attention of the Enforcement and Compliance Division of this Office to date, there has been no evidence that an assured source of funds is available as indicated by those promoting such disbursements. While it is recognized that some intermediary brokers may be innocent of any inappropriate activity, banks are advised to view any solicitation with extreme caution and to report any questionable contacts to:

Robert B. Serino, Director
Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

Paul M. Homan

Paul M. Homan
Acting Comptroller of the Currency

Date October [illegible], 1981

Page 2 of 2

BC - 141
SUPPLEMENT #3

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type **Banking Circular** Subject **Brokered Funds**

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; District Deputy Comptrollers; Examining Personnel

This issuance is a third supplement to Banking Circular 141, dated May 2, 1980, followed by Supplement 1, dated October 9, 1981, and Supplement 2, dated July 14, 1982. These banking issuances identified the undue risk factors present in proposed large money transactions brokered, for the most part, by persons who purportedly have access to lending sources which generally are not identified. In every proposed funding situation brought to the attention of this Office, an involvement of a United States bank appears necessary to provide credibility. To date, no evidence has been received indicating that an assured source of funds either exists or is controlled in any manner by those persons offering such services. No actual funding based on the terms represented has ever been reported to this Office.

Prudent banking dictates that full disclosure of all aspects of this type of financial transaction be made by all parties before there is any committed involvement by a bank. The lack of such proper preliminary action in which a bank has committed itself, including acting as agent, custodian, and in other presumed limited liability capacities, exposes the bank to possible civil litigation initiated by brokers, proposed borrowers, proposed lenders, and others so associated with the proposed transaction. Attendant litigation usually cites the committed bank which agreed to accept the funds as being responsible in some manner for the failure of the funding. Again, it is suggested that extreme caution be exercised when evaluating these proposed transactions. Any information regarding threatened, pending, and previous litigation arising from such involvements should be reported to:

Enforcement and Compliance Division (202-447-1847)
Office of the Comptroller of the Currency
Washington, D.C. 20219

C. T. Con

C.T. Conover
Comptroller of the Currency

Date December 8, 1983

Page 1 of 1

BC - 141
SUPPLEMENT 2

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Brokered Funds

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; Regional Administrators; Examining Personnel

This issuance is the second supplement to Banking Circular #141 dated May 2, 1980, which highlighted some of the hazards faced by banks becoming involved in abnormal money-brokered transactions. This Office continues to receive information about proposed large money fundings to be placed through United States banks with the source of such placements being a foreign entity lender not otherwise identified. Some banks have attempted to assist customers who represent themselves as borrowers and/or brokers in such endeavors. The involvement of a United States bank appears necessary to provide credibility to the proposed financial transaction.

In recent months, it has been brought to our attention that certain brokers have been circulating letters of this Office which purportedly give their proposals credibility. You are advised that at no time has this Office encouraged, approved, or in any manner supported the furtherance of any such financial transaction involving multimillions of dollars originating from undisclosed foreign lenders and which reflects terms and rates far more favorable to the borrower than can be obtained from normal market sources. Any such representations citing this Office as being in support of such brokered funds transactions should be disregarded.

Extreme caution is suggested in evaluating these transactions. It is suggested that each bank establish a central contact for these types of offers and should bring them to the attention of:

Robert B. Serino, Director
Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

C.T. Conover
C.T. Conover
Comptroller of the Currency

Date July 14, 1982

Page 1 of 1

EXAMINING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Examining Circular

Subject: Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, 31 CFR 103

TO: Deputy Comptrollers (District)[1], District Administrators, Department and Division Heads and All Examining Personnel

PURPOSE

The purpose of this issuance is to set out specific guidelines for ensuring that national banks and Federal Branches and Agencies comply with the Bank Secrecy Act.

REFERENCE

- Banking Circular #49 and Supplement 5.
- Banking Bulletins 80-18 and 83-8.
- Banking Circular 193.

BACKGROUND

There is recent evidence of a lack of compliance with the Bank Secrecy Act by certain members of the banking industry. Particular areas of concern include:

- the detailed completion and proper filing of Form 4789 for currency transactions in excess of $10,000 with foreign banks and Form 4790 for transportation of currency in excess of $10,000 to or from the United States. (The filing of Form 4790 does not eliminate the necessity of filing Form 4789 and vice versa.);
- the required filing of Form 4789 for cash purchases of checks/money orders/securities/etc., currency exchanges or other cash transactions. (The exemption list provisions apply only to deposits and/or withdrawals by an established depositor who is a United States resident and all transactions with government agencies or instrumentalities.);

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[1] In those instances that involve a Multinational bank, throughout this issuance, the Deputy Comptroller for Multinational Banking should be substituted for District Office or Deputy Comptroller (District).

Date: April 24, 1985

- the compilation and maintenance of a centralized, current and accurate list with appropriate information of established deposit customers whose deposits and/or withdrawals are permitted to be exempt from reporting requirements;
- the legality and reasonableness of the customers listed on the exemption list. Attention is drawn to 31 CFR 103.22 which lists specific types of businesses that qualify for exemption; and
- the filing of written reports of potential violations of criminal law as required under Interpretive Ruling 7.5225.

As a result of these concerns, national banks have recently been reminded to establish and enforce policies and operating procedures to ensure compliance with all parts of the Bank Secrecy Act. Particular emphasis was directed to having a bank thoroughly evaluate its current policies and procedures with regard to the Bank Secrecy Act (reference Banking Circular 193).

Our Strategic Plan continues to recognize the need to achieve an appropriate balance between safety and soundness objectives and compliance requirements. While the currently strained financial condition of certain domestic and foreign borrowers has resulted in a shifting of the balance toward significant problems in the safety and soundness area, the OCC remains committed to compliance. Examinations will continue under the current examination schedule, with compliance remaining an integral part of the examination function.

Examination Scope

For Comprehensive and Community Bank Examinations, examining personnel should ensure that the Form CC-1425-CL (checklist) is completed and signed by a bank official and that sufficient steps within the Audit Function Questionnaire, ICQ, and Examination Procedures are performed to determine compliance with the Bank Secrecy Act. Where deficiencies are uncovered, selected verification procedures should be completed to determine the full extent of the problems.

For Targeted Examinations,[2] the scope of the Bank Secrecy Act examination should be determined from a review of internal and external audit coverage, internal controls, previously noted deficiencies, and information available on potential non-compliance from Treasury and other sources. In all cases, the checklist should be completed and signed by a bank official. The evaluation of internal and external audit and internal controls must be well documented in the workpapers to support the examiner's judgment on the scope determined and the bank's system of insuring compliance.

For ARVs, the checklist must be completed and signed by a bank official. In addition, a review of audit coverage, internal controls, previously noted deficiencies, and information on potential non-compliance should be performed. If concerns about a bank's compliance or lack thereof are raised from this review, appropriate examination procedures should be performed or a compliance examination should be scheduled.

If any bank has been designated by the Treasury Department, U.S. Customs, or by other sources, as potentially being in non-compliance, the scope of the examination must include the procedures required in a Comprehensive Examination.

Processing Procedures

Current instructions require Form CC-1425-CL (Checklist) to be submitted with the report of examination only when violations are noted. Effective immediately, regardless of whether violations are noted, a copy of the form signed by bank management shall be forwarded with the ROE and a copy retained in the workpapers. In those cases where bank management refuses to sign the checklist, such refusal and the reasons therefore should be documented on the form by the examiner.

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[2] For all banks that receive more than one Targeted Examination during a 12-month period, Bank Secrecy Act compliance need only be in the scope of one of the year's scheduled examinations unless otherwise warranted or designated.

The Chief National Bank Examiner's Office will be responsible for direct coordination of efforts with Treasury. This includes disseminating information received from Treasury, such as notices of investigations and analysis reports of CTR filings, to District management and other affected parties. Under the oversight and direction of the Chief National Bank Examiner's Office, District management shall establish procedures for: 1) communicating in writing to examiners-in-charge information regarding institutions designated for suspected non-compliance including any special guidance on procedures to follow; 2) monitoring that findings are adequately reported and that appropriate followup is made; and 3) monitoring that examinations include Bank Secrecy Act compliance procedures as outlined in this issuance. The District offices in turn will report quarterly on their findings and status of examinations to the Chief National Bank Examiner's Office as required by PPM 5000-13, dated November 1, 1982. In addition, when banks have come forward and discussed violations with the Department of Treasury and District offices, memoranda of such meetings should be prepared and forwarded to the Chief National Bank Examiner's Office.

Referrals for Potential Violation of Law

Examining and District personnel are reminded to review a bank's procedures and transactions to determine if there are violations of the Bank Secrecy Act that should be the subject of a referral for possible criminal and/or civil money penalties. A separate memorandum detailing the facts of the violation may be necessary for ultimate referral. Also, unless it is believed that there is a possibility of destruction of evidence or a cover-up, examiners may discuss the problems with appropriate bank officers to obtain corrective action. As in cases of other violations of law, they should be cited in the Report of Examination. Examiners should not, however, indicate that by correcting the violations no further action will be taken by the Treasury Department. District offices should review and forward all referrals of violations with recommendations to the CNBE for review and coordination with the Treasury Department.

EC- 228

EXAMINING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Examining Circular

Subject Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, 31 CFR 103

Amendments to Comptroller's Handbook for National Bank Examiners

Comptroller's Handbook For National Bank Examiners. Section 201.1, page 2, "Currency Transaction", 6th and 5th lines from bottom, delete: "If violations are disclosed,". Section 201.3, page 2, question 9.f., last sentence, delete: "In the absence of any no answers". Insert after the word "retain": "a copy of". Place a note in the margin at both locations: See EC 228.

ORIGINATING OFFICE

Chief National Bank Examiner, Commercial Examinations Division, (202) 447-1164.

H. Joe Selby
Senior Deputy Comptroller
for Bank Supervision

BB. 85-27

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Bulletin

Subject: Financial Recordkeeping and Reporting of Currency and Foreig Transactions Act, 31 CFR 103

TO: Chief Executive Officers of All National Banks, Officers in Charge of Federal Branches and Agencies, Deputy Comptrollers (Districts), District Administrators, Department and Division heads and All Examining Personnel

Attached for your information is an Internal Revenue Service press release issued December 19, 1985 regarding IRS Form 4789, Currency Transaction Report. You will note that the implementation date is July 1, 1986. For the period January 1 through June 30, 1986 continue filing the existing Form 4789.

This Banking Bulletin automatically expires July 1, 1986.

John F. Downey
John F. Downey
Chief National Bank Examiner

Attachment

Date: December 20, 1985

Page 1 **of** 1

News Release

Department of the Treasury
Internal Revenue Service
Public Affairs Division
Washington, DC 20224

Media Contact: Tel (202) 566-4024
Copies: Tel. (202) 566-4054

For Release: 12/19/85

IR-85-119

Washington—The Internal Revenue Service today announced that a revised Form 4789, Currency Transaction Report, will become effective on July 1, 1986, for transactions of more than $10,000.

Until that date, the IRS said financial institutions should continue to file the existing Form 4789. Additional supplies of the existing form can be ordered from IRS forms distribution centers.

Financial institutions can obtain a copy of the newly revised Form 4789 for the purpose of developing internal procedures or making necessary computer programming changes by sending a request to the IRS Data Center, Attn: Currency and Banking Report Division, 1300 John C. Lodge Freeway, Detroit, MI 48226.

X X X

BB- 86-9

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Bulletin

Subject Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, 31 CFR 103

TO: Chief Executive Officers of All National Banks, Officers in Charge of Federal Branches and Agencies, Deputy Comptroller (Districts), District Administrators, Department and Division Heads and All Examining Personnel

PURPOSE

This issuance provides guidelines for amending/refiling Currency Transaction Reports (CTR), Form 4789.

BACKGROUND

The Internal Revenue Service (IRS) receives CTRs and enters this information into a data base. Due to the increased volume of CTRs being filed, processing backlogs have occurred. The cause of the increase is: 1) greater compliance awareness by the entities required to file CTRs and 2) an influx of CTRs being amended because of prior inadequacies.

PROCEDURES

Amended CTRs have resulted in duplicate entries into the data base. To minimize this occurrence the Department of the Treasury and IRS have developed guidelines for amending a CTR. The guidelines should be implemented immediately.

1. On a copy of the CTR originally filed, circle in red the incorrect, illegible or missing information.
2. On a blank CTR, enter "AMENDED" or "CORRECTED" in the top margin above the Currency Transaction Report legend.
3. Enter only the correct or amended information on the blank form in the appropriate line item or box.
4. Sign and date the amended or corrected form.
5. Staple the amended or corrected form on top of the copy of the originally filed form.

BB-86-9

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Bulletin

Subject Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, 31 CFR 103

6. Mail the CTR to the IRS Data Center, P. O. Box 32621, Detroit, MI 48232 ATTN: CTR Processing.

ORIGINATING OFFICE

Chief National Bank Examiner's Office, Commercial Examinations Division, (202) 447-1164.

John F. Downey

John F. Downey
Chief National Bank Examiner

Date April 9, 1986

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

Bank Supervision Newsletter

July 1985 *Number 8*

COMPTROLLER NOTIFICATIONS: A TIGHT HAND

Within the past month, the Comptroller's Office has issued several Banking Issuances to drive home the point that national banks—and especially their senior management—are at risk in the future if they claim lack of awareness of several important rules.

The issuances cover a variety of issues:

1. Reworked (and somewhat tightened) Change-In-Control disclosure policy.
2. Prudent controls for securities lending (reflecting joint Federal agency agreement on recordkeeping, credit analysis, concentration limits, and reporting).
3. Strict guidance on the purchase of "junk bonds" either in a fiduciary role or as investments (or their eligibility as borrower collateral).
4. The Federal Reserve's final rule implementing the FTC's Credit Practices Rule (no pyramiding late charges, prohibited credit, obligation provisions, written notice of cosigner liability);
5. Direct policy guidance on the accounting for gains and losses on foreign loan "swaps"—including a presumption that "...the estimated fair values (of such loans) will be less than the respective face values...result(ing) in a loss on the swap".
6. Reaffirmation of specific limits on Loan Production Office operations—along with strong advice that banks tighten up on liberal interpretations of LPO loan pro-

(continued on page 2)

In This Issue...

- *Comptroller Notifications: A Tight Hand*
- *Concentrations of Credit*
- *Disclosure*
- *Civil Money Penalties*
- *Determining the ATRR*
- *Agricultural Report of Condition*
- *Bank Secrecy Act and Trust*
- *Noninterest Income*

CONCENTRATIONS OF CREDIT

The OCC has collected information on concentrations of credit in national banks since January 1984. This data is collected through the Statistical Data Sheet (SDS). Compiled information is available on the National Bank Surveillance Video Display System (NBSVDS).

A recent review of the database noted the existence of 3,991 concentrations of credit in 1,928 national banks. Surprisingly, 2,317 banks, which constitute 55 percent of the 4,245 examinations available in the SDS database, report no concentrations. Concentrations in the agricultural industry are by far the largest. The most frequently cited credit concentrations are:

Rank	Description	Number of Banks
1.	Crops—grain	600
2.	Livestock—beef, hogs, sheep	587
3.	Real estate finance	409
4.	Residential construction	388
5.	Nonresidential construction	260
6.	Oil and gas	216

The concentrations are in distressed economic sectors. Special call reports have been created for banks with concentrations of farm and oil credits. These special call reports gather additional information on the financial condition of the borrowers in the particular industries. This, in turn, provides additional information on the overall condition of the affected banks and promotes more effective supervision.

Alan Wachter
National Bank Examiner
Community Bank Analysis Division

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

Bank Supervision Newsletter

August 1985 *Number 9*

In This Issue...

- *ADC Loans*
- *Training Team Coup*
- *National Banks' Operations—First Quarter 1985*
- *Bank Secrecy Act*
- *ATRR Accounting Treatment*
- *Employee Benefit Plans*

ADC LOANS

A new accounting buzz word in financial institutions (primarily savings and loan associations) is "ADC loans." The acronym stands for real estate "acquisition, development and construction loans." Calling them loans may be a misnomer. Some ADC loans provide the same risks and rewards as ownership, they could be considered real estate investments. The distinction, for banks, could have implications in evaluating risk and compliance with 12 U.S.C. 29.

Examiners should review these ADC arrangements carefully to determine whether the ADC arrangement is a loan or an investment. The assessment should be based upon the risks and rewards involved in each specific case. The determination should be made on the basis of whether the bank is primarily acting as a lender or investor. If the examiner concludes the ADC arrangement is a real estate investment, the examiner should cite a 12 U.S.C. 29 violation.

In a true loan arrangement, the bank usually requires the borrower to have a substantial equity investment in the venture. Additionally, the bank may have recourse against other assets of the borrower. Further, there may be a take-out commitment or noncancelable sales contract or lease commitment that guarantees sufficient cash flow to protect the bank.

An ADC arrangement that may be considered an investment has most of the following characteristics:

- The bank participates in the expected residual profit of the venture. (12 CFR 7.7312 allows a national bank to take as consideration for a loan a share in the profit from a business en-

(continued on page 2)

TRAINING TEAM COUP

What should examiners do when they discover massive fraud? For the answer, ask the Birmingham, Alabama, training team. That training team discovered fraud which caused a "clean" bank (just right for training purposes) to deteriorate to an insolvent bank.

It all started during a routine examination of the loan portfolio at the First National Bank of Jacksonville, Alabama. The team noticed several red flags—common post office box numbers, common types of collateral, and similar-style financial statement information—among a group of commercial loans. Dissatisfied with the explanations provided by the bank's chief executive officer, the training team performed a positive direct verification of the questionable loans.

When the examiners notified the chief executive officer that direct confirmations would be sent, he promptly left the bank for a doctor's appointment, never to return. Federal Bureau of Investigation authorities are still trying to locate him.

The total of the fraudulent loans, $10 million, far exceeded the bank's capital of $3.7 million. On July 5, 1985, the training team became the closing team when Deputy Comptroller Michael Patriarca declared the bank insolvent. The Birmingham, Alabama, training team and their supervisors are to be commended for their diligence in pursuing the red flags of white collar crime.

Paul R. Feugheiser
National Bank Examiner
Special Projects Division

(AGRICULTURAL from page 3)

are: less than 40 percent, greater than 40 percent but less than 70 percent, greater than 70 percent but less than 100 percent, and over 100 percent.

Information is being collected by both product line and indebtedness level so the OCC can identify banks which are the most susceptible to changing economic events. These banks will then be selected and/or targeted for ongoing analysis, closer scrutiny or examination. The OCC will be able to identify and analyze agricultural trends by geographical areas, by concentrations in particular commodities or livestock, and the borrowers' debt/asset ratio.

This information will allow the OCC to make informed decisions on agricultural banks. The OCC will also be better able to develop policies and procedures to respond to developing situations.

Tom Watson
National Bank Examiner
Community Bank Analysis
Division

BANK SECRECY ACT AND TRUST

National bank trust departments are required to comply with the recordkeeping and reporting requirements contained in both the Bank Secrecy Act (Act) and Section 21 of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. 1829b.

The Act requires that whoever knowingly transports or causes to be transported "monetary instruments" into or out of the United States or receives "monetary instruments" in the United States in excess of $5,000 on any one occasion must file certain reports with the Secretary of the Treasury. It is clear from the definitional provisions of the Act that bank trust departments are included within its requirements.

In order to ensure compliance with the Act and its implementing regulations, the Trust Examinations Division is developing examination procedures for inclusion in a supplement to the *Comptroller's Handbook for National Trust Examiners.* Until the procedures are developed, examiners should be familiar with Section 201.1 and appropriate examination procedures in the *Comptroller's Handbook for National Bank Examiners* prior to examining trust departments for compliance with 31 CFR 103.

Arthur W. Steele
National Trust Examiner
Trust Examinations Division

NONINTEREST INCOME

A combination of causes (such as deregulation, increased competition and economic factors) have put pressure on bank earnings in recent years. One possible strategic response to this pressure has been to increase noninterest income.

National banks have been very successful in generating additional fee income. Total noninterest income in national banks has more than doubled between 1980 ($8.4 billion) and 1984 ($17.3 billion).

The 5-year growth rate for noninterest income between 1980 and 1984 at 107 percent is significantly greater than the growth rates in other financial accounts. The growth rate for net interest income was 53 percent, 48 percent for total operating income and 70 percent for overhead expense.

Noninterest income in national banks has risen from 0.84 percent of average assets in 1980 to 1.23 percent in 1984, a 39 basis point increase. This increase in noninterest income has not resulted in a commensurate increase in earnings. The costs of providing fee generating services have caused overhead expenses to grow more rapidly than assets. Increased provisions to the Allowance for Loan and Lease Losses have also slowed earnings growth.

While the growth rates noted above are similar for banks of all sizes, noninterest income is a more significant account in the largest banks. Noninterest income represents 1.33 percent of average assets in national banks with assets over $1 billion. This is not surprising, considering the higher levels of off-balance sheet fee generating activity (such as fee paid loan commitments) in these banks.

There are significant differences in the composition of noninterest income in the various size banks. Deposit service charges account for over 56 percent of fee income in banks with assets under $100 million, but represent only 17 percent of noninterest income in billion dollar banks. Income from trading accounts, foreign exchange and other foreign transactions is almost all generated by the billion dollar banks.

Alan J. Wachter
National Bank Examiner
Community Bank Analysis
Division

BANK SECRECY ACT

Several amendments to the Bank Secrecy Act, 31 CFR 103, have been enacted in 1985. So that examiners will be familiar with the changes, a synopsis of the major amendments is provided below:

- Amendment effective May 7 incorporates gambling casinos into the definition of "financial institution" and makes them subject to all requirements of the Bank Secrecy Act (31 CFR 103.11).
- Amendment effective May 31 increases the reporting requirement on Form 4790 from $5,000 to $10,000. Paragraph (b) of this section was *not* statutorily changed and the requirement remains $5,000. (31 CFR 103.23(a))
- Amendment effective May 31 changes the ceiling on civil penalties from $1,000 to $10,000. (31 CFR 103.47(a))
- Amendment effective May 31 adds a new paragraph which states: "Any person who willfully violates any provision of title II of Pub. L. 91-508, or of this part authorized thereby, may, upon conviction thereof, be fined not more than $250,000 or be imprisoned not more than 5 years, or both." (31 CFR 103.49)
- A new section effective May 31 provides rewards for informants who provide original information leading to a recovery of a criminal fine, civil penalty, or forfeiture, which exceeds $50,000. (31 CFR 103.52)
- Amendment effective August 7 defines a foreign financial agency as: "A person acting outside the United States for a person (except for a country, a monetary or financial authority acting as a monetary or financial authority, or an international financial institution of which the United States Government is a member) as a financial institution, bailee, depository trustee, or agent, or acting in a similar way related to money, credit, securities, gold, or a transaction in money, credit, securities or gold."
- Amendment effective August 7 establishes a regulatory procedure through which the Secretary of the Treasury can require financial institutions in the United States to submit reports of financial transactions with foreign financial agencies (31 CFR 103.25).
- Sections 103.25 (Filing of Reports) and 103.26 (Identification Required) were renumbered 103.26 and 103.27, respectively. *NOTE:* Please record this change immediately since it will affect the violation of law cites and the OCC's quarterly report to the Department of Treasury. These new cites should be used for transactions occurring on or after August 7, 1985.

An update to the *Comptroller's Manual For National Banks* incorporating all changes to the Bank Secrecy Act is being compiled and will be distributed in the near future.

Thomas C. Lehmkuhl
National Bank Examiner
Commercial Examinations Division

ATRR ACCOUNTING TREATMENT

An Allocated Transfer Risk Reserve (ATRR) must be established for each asset, when required, in the amount specified by the Federal banking agencies. The ATRR is established by a charge to current income and the amounts charged are not included in the banking institution's total capital. The ATRR is separate from the Allowance for Loan and Lease Losses (ALLL), and is deducted from gross loans and leases.

The ATRR is established for banks, bank holding companies, and Edge and Agreement corporations, as required, on a consolidated basis in accordance with the procedures and tests of significance set forth in the instructions for preparation of Call Reports or other Federal regulatory recordkeeping requirements.

A banking institution need not establish an ATRR if it writes down, in the period in which the ATRR is required, or has written down in prior periods, the value of the specified international assets in the requisite amount for each asset. Such assets may be written down by a charge to the ALLL, or a reduction in the principal amount of the asset by applying interest payments or other collections on the asset. However, the ALLL must be replenished in an amount necessary to restore it to a level which adequately provides for the estimated losses inherent in the banking institution's portfolio.

Leon S. Tarrant, Manager
ICERC Secretariat

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

Bank Supervision Newsletter

October 1985 *Number 11*

SALE OF BANK ASSETS

Recently, a large bank announced a plan to sell many of its nonperforming assets and international loans to its parent and other affiliates. Although the transaction will result in a stronger bank, it is interesting to note that the bank will book a $50 million loss (before taxes and other offsetting gains) on the sale.

It may be questioned whether such a loss should be recognized since the assets are simply moved from one affiliate to another. The answer depends on which entity is reporting the transaction and on the governing accounting rules—GAAP or RAP (regulatory accounting principles).

On a consolidated basis, GAAP and RAP are in agreement—no loss would be recognized. However, when a bank reports the transaction, there may be a difference. Accounting under GAAP may or may not result in loss recognition, but RAP clearly requires booking a loss if the assets are currently worth less than the book value.

A gain or loss on a transaction is measured by the difference between the book value of the assets and their fair market value regardless of the amount paid by the affiliate. If a bank were to receive an amount greater than the fair market value—such as book value—the excess would be booked as a capital contribution.

We frequently see similar transactions of a smaller magnitude involving the sale of loans, securities and other assets to affiliates. They may also involve sale/leaseback transactions, sales of charged off loans or exchange of securities.

Sales or exchange transactions are generally motivated by tax and capital considerations. Although the transactions vary in type and complexity, the accounting is generally the same. Fair market values must be determined, and the accounting may include a gain or loss coupled with either a capital contribution or a "constructive" dividend. This accounting treatment ensures that the transaction is recorded on the same basis as if the

(continued on page 3)

In This Issue...

- ***Sale of Bank Assets***
- ***Bank Secrecy Act Referrals***
- ***R E Construction Loan Survey***
- ***Global Banking Markets***
- ***International Monetary Fund***
- ***Trust Support Services***

BANK SECRECY ACT REFERRALS

A Policy and Procedures Manual issuance regarding referral recommendations for Bank Secrecy Act (BSA) violations is being developed. In the interim, please be guided by Examining Circular 228, dated April 24, 1985 and supplemental information provided in this article.

The Department of the Treasury is responsible for pursuing BSA referrals. The OCC's responsibilities include furnishing information to Treasury "for further investigation and consideration for *civil* or *criminal* penalties." The examiner and District Counsel are relieved of specifying the type of penalty that should be assessed since Treasury/IRS will make that determination pursuant to an investigation. If, however, the examiner chooses to recommend a criminal referral, follow the guidelines in Banking Circular 207.

The examiner's recommendation for a referral should include comments regarding bank management's commitment to comply with the act, as well as the nature and magnitude of the BSA violation. If such information is included in the report of examination, copies of the appropriate pages may be attached to the referral.

Documentation of BSA violations should be retained with

(continued on page 2)

(BSA REFERRALS *from page 1*)

the workpapers. In the event Treasury authorizes further investigation, the documentation may be requested by IRS agents.

Referral Criteria

Questions have arisen regarding the nature and number of violations that warrant a referral. While the decision is left to examiner discretion, the most common situations include:

- Failure to file Form 4789, whether intentional or not:
  - in more than an insignificant number of reportable transactions,
  - as a pattern or practice at a certain location,
  - as a pattern or practice for a specific customer/account;
- More than an insignificant number of technical violations; i.e., incomplete/inaccurate Forms 4789;
- Failure to maintain an exempt customer list, except when management does not authorize any exemptions;
- Inclusion of ineligible entities on the exemption list;
- Lack of internal controls and/or audit coverage regarding the BSA in combination with violations of the act; and
- Failure to maintain specific information regarding deposit accounts, certificates of deposit and loans as detailed in the regulations.

The referral document should be in memorandum form and forwarded by the examiner-in-charge to District Counsel. This procedure should be followed in all cases except multinational bank cases, which should be sent directly to the Director, Multinational and Regional Bank Supervision.

The *Bank Supervision Newsletter* is a compilation of articles from the various Bank Supervision Divisions. The newsletter is published monthly by the Chief National Bank Examiner's Office under the editorship of James E. Tracy, Deputy Director, Commercial Examinations Division.

Subsequent to review and approval by District Counsel or Director, Multinational and Regional Bank Supervision, the recommendation will be forwarded to the Chief National Bank Examiner's Office for administrative coordination.

If you have questions regarding cases you wish to refer, contact District Counsel or the District BSA Specialist.

Thomas C. Lehmkuhl
National Bank Examiner
Commercial Examinations Division

REAL ESTATE CONSTRUCTION LOAN SURVEY

Many parts of the country are faced with an oversupply of commercial real estate and many banks are experiencing growing problems in real estate portfolios. High vacancy rates and disinflation have led to rent concessions, declines in property value and diminished collateral support for many real estate loans. In light of these adverse economic developments, in July, the OCC sent a real estate construction loan survey form to a selected number of large bank holding companies and banks. The selected companies and banks represented more than $900 billion in total assets and had a significant volume of activity in construction lending. Survey results are currently being analyzed.

The purpose of the survey was to determine the extent of construction lending within each banking company or bank. The survey results will determine the major loans according to type of project (office building, land development, etc.) and the location of the project according to metropolitan statistical area.

Survey Content

The survey was designed to provide the detail necessary to evaluate the potential for risk being taken in the marketplace as a whole and by individual companies and banks. The following is a brief description of information requested:

- Provisions in lending policies relating to appraisals, revaluing property, loan review, loan loss reserves, etc;
- Dollar amount of the construction loan portfolio categorized by type—non-residential, residential and land development—and further broken down by categories such as retail stores, office buildings, condominiums, apartments, etc. In addition, the amount of standby letters of credit, past-due and non-accrual loans for each real estate loan category;
- Breakdown and dollar amounts of internal loan classifications by categories such as office buildings, condominiums, etc.
- Breakdown and dollar amounts of non-residential and land development loans greater than $3 million situated in the 50 largest metropolitan statistical areas;
- Breakdown and dollar amounts of office building loans greater than $3 million by metropolitan statistical area and the percentage of loan to appraised value.

A major issue, as seen by OCC staff, is the adequacy of the appraisal supporting the loan on a construction project. Do appraisals reflect the current market value of the real estate collateral when adverse economic conditions occur? Under the new supervisory approach, the institutions exhibiting significant risk in construction lending will receive increased supervisory attention.

Gary H. Christensen
National Bank Examiner
Community Bank Analysis

Policy Group Endorses SSP Recommendations

by Gerry Hagar, *Strategic Planning*

The recommendations that came from more than seven months of brainstorming, interviewing, and writing by the Strategic Systems Planning (SSP) Team have been endorsed by the Policy Group.

The team developed their long-range plan for improved OCC information management using techniques developed by the Holland Systems Corporation. After designing a functional business model that categorizes OCC activities into various "businesses," such as licensing and supervision, the team recommended several steps that would lead OCC to more unified information systems.

- Construct shared databases to replace the 80 existing mainframe databases.
- Give priority attention for the next 1 to 2 years to development or refinement of systems in the areas of:

Management planning and reporting — Specifically, strategic and operating plan development and coordination, management reporting, and program tracking.

Bank supervision — Specifically, systemic risk identification, assessment and strategy development and individual institution supervision.

Resource management — Specifically staffing plan and career path development, affirmative action, recruitment, internal placement, and training activities.

Completion of this project is an important step in achieving an integrated, usable and responsive information system that will serve OCC's present and future information needs.

The SSP Team — Gerry Hagar, Ron Lindhart, Dave Perkins, Cindy Petitt, Darrell Sheets and Melanie Smith — are now turning their recommendations over to Management Systems and Information Systems and Technology for implementation. There is still much work to do to complete the project and accomplish the recommendations.

health coverage, you should arrange with the Payroll Office to continue family coverage during LWOP (there is no cost for individual coverage). After 365 days of LWOP, your coverage ends. If you return to an active duty status you may re-enroll.

OCC Life and FEGLI coverage stays in force for up to one year with no further payment. After one year, your coverage ends with no conversion privileges.

Dental and Vision coverages continue at no cost for up to one year while you are on LWOP. At the end of that time the coverages end. If you return to active duty, coverages will be automatically reinstated.

Long-term Disability coverage continues as long as you are in a non-pay status, if your non-pay status is for medical reasons (medical documentation is required). Otherwise, coverage ends when LWOP be-

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IRS Bank Secrecy Responsibilities Expand

by Thomas C. Lehmkuhl,
Commercial Examinations

On September 6, 1985, the Department of the Treasury signed a delegation order giving the Internal Revenue Service (IRS) certain authorities under the Bank Secrecy Act (BSA). Under that delegation, the IRS becomes responsible for reviewing the exemption lists developed and maintained by financial institutions. The delegation became effective January 1, 1986.

The IRS also became responsible for reviewing special-case exemptions and exemptions that banks feel are justified under BSA but are not covered by the law's list of standard exempt activities. Exemption requests should no longer be submitted to the Department of the Treasury. Such requests should be made to the Internal Revenue Service, P.O. Box 32063, Detroit, Michigan 48232.

Although the IRS's plans to review existing exemption lists are not yet complete, it is clear that those lists will be reviewed. If the IRS finds a customer not acceptable for exemption, it will require the financial institution to remove the customer from the exempt list and to file Currency Transaction Reports (CTRs). As yet it is unclear whether the IRS will require retroactive CTR filings for such customers.

OCC Publishes "The Changing Shape of Retail Banking"

by Janet Gordon, *Customer and Industry Affairs*

What does the future hold in store for banks, their customers, and the bank-customer relationship? OCC has recently published a lively discussion of this question in "The Changing Shape of Retail Banking: Responding to Customer Needs." The booklet, now available upon request from the Communications Division, is a detailed summary of a conference sponsored last June by the OCC.

The conference, developed by the Customer and Industry Affairs Division, gave bankers, customer group representatives, industry experts and agency leaders an opportunity to exchange information and opinions on a variety of timely issues — from innovations in low-cost basic banking services to the latest in bank technology for branches.

The publication summarizes presentations and discussions from four workshop sessions, which dealt with:

1. Reconfiguration of retail service delivery systems, including branch closing policies, new technologies, and innovative branch types;
2. Small business products and delivery systems, including special small business centers and innovative business advisory services;
3. Consumer services, including basic banking services and innovative consumer lending and education programs; and
4. Community investment, including aggressive mortgage lending using revenue bond and secondary market programs and an innovative minority small business development program.

Also included are texts of the three major presentations — Michael A. Mancusi's opening remarks on OCC customer-oriented activities; remarks on banking deregulation and consumer interests by Paul Horvitz, Professor of Banking and Finance at the University of Texas; and an overview of current trends in bank-customer relationships by Raoul Edwards, editor of *U.S. Banker*.

The OCC publication has been provided to department and division heads and many national, regional and state banking and customer organizations. Copies are available from the Communications Division by writing them at the Washington Office or by calling 447-1768. Questions regarding the Conference should be directed to Malloy T. Harris, Jr., or Janet R. Gordon on 287-4169.

el or program you find useful, please contact your Users' Group representative to have it presented to the group for review and distribution throughout OCC.

The Microcomputer Users' Group representatives are:

Name	**FTS Number**	**Unit**
Larry Horn	8-597-5894	Northeastern District
David Scott	8-242-3792	Southeastern District
Mark Bryant	8-886-1135	Central District
Terry Anstine	8-864-4811	Midwestern District
John Brown	8-729-5750	Southwestern District
Don Ewan	8-545-5927	Western District
Bill Dehnke	8-447-1896	Chief Counsel's Office
Dave Nichols	8-447-1360	Policy and Planning
Ed Reedy	8-447-1920	Multinational and Regional
Jonathan Faulkner	8-447-1723	Operations Analysis
Tom Treichler	8-447-1445	Bank Supervision

IRS and the Bank Secrecy Act

by Thomas C. Lehmkuhl, *Commercial Examinations*

The Internal Revenue Service (IRS) has embraced its newly delegated authorities under the Bank Secrecy Act (BSA) and is actively seeking to strengthen the administration of BSA compliance. IRS is increasing the staff available and hopes to provide more assistance to those with BSA problems. The IRS Data Center in Detroit, Michigan is expected to reach its target level of 300 by the summer of 1986. That staff will process Form 4789, address BSA questions, provide rulings and interpretations of the Act and respond to requests for exemptions.

Contacting IRS

IRS is planning a toll-free "800" telephone number to allow them to be more responsive to financial institutions, examiners, attorneys, etc. Until the number is available, field examiners should contact their District Counsel who will contact IRS.

Examiners should remind bankers to document telephone conversations with IRS.

In conversations with bankers, examiners should provide the following BSA contacts:

General BSA information:

IRS Data Center
Currency and Banking Report Division
1300 John C. Lodge Freeway
Detroit, MI 48226

Commercial (313) 226-3525
FTS (8) 226-3525

Exemptions and exemption lists:

IRS Data Center
Currency and Banking Reports Division
P.O. Box 32063
Detroit, MI 48232

Dick Gabany: Commercial (202) 566-6474
FTS (8) 566-6474

Addressing Past Violations of BSA

When Forms 4789/4790 are not filed, an ineligible customer is included on the exemption list, and/or a number of Forms 4789 are incomplete/inaccurate, examiners must direct the bank to contact IRS to determine what corrective action should be taken. Examiners should note in the workpapers and supervisory letter their instructions to the bank.

Reviewing Exemption Lists

OCC is still responsible for reviewing exemption lists. There seems to have been some confusion regarding the IRS press release attached to Banking Circular 193, Supplement 3. By delegation, IRS *may* request and review the exemption list of any domestic financial institution. However, IRS will concentrate its review on institutions not regulated by federal financial institution regulators. If IRS reviews a national bank's exempt list, OCC will receive a report of the findings.

It is important that employees maintain flexibility in airline selection, rather than insisting on preferred carriers. The difference in fares can be dramatic. For instance, one airline flies from LaGuardia to O'Hare for a government rate of $210 round trip and offers four flights each day. Two other airlines charge $540 for the same trip, a difference of $330. An employee flying from Washington to Dallas at the government rate pays $234 round trip, compared to $660 full coach fare, a difference of $426. Cost differences of more than 150 percent are significant, particularly when multiplied by the number of trips taken OCC-wide.

SATO will automatically search for the lowest available fare in the hour before and the hour after your requested departure time. You will not be required to change planes en route to get a cheaper fare or to take a flight with more than one stop. Exceptions to the lowest cost rule may be granted when the lowest fare flight will not arrive in time to accomplish the purpose of your trip.

OCC Adopts New Home Sale Program

by DeeDee Bryant,
Benefits and Travel Services

Under a new IRS position, a relocating employee who secures an offer higher than Homequity's offer can turn that offer over to Homequity and receive the entire equity payment immediately, based on the higher offer. Before 1986, employees could assign a higher sale to Homequity and receive full equity only after the sale had been closed. The program change is a result of the IRS position that brokers' commissions paid through assigned sale programs are income to the employee. This new OCC amended value program does not result in taxable income by IRS standards.

Employees who receive higher offers should coordinate closely with their Homequity counselors to ensure that the necessary requirements are met. It is imperative that employees not sign offers, accept earnest money or accept downpayments on their homes. Anyone who does so cannot participate in the Homequity program. Of course employees who choose to sell their homes completely independent of Homequity will still be reimbursed for allowable closing costs and the gross up.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 7 and 21

[Docket No. 85-14]

Reports of Suspected Crimes

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC) proposes to eliminate Interpretive Ruling § 7.5225 (12 CFR 7.5225) regarding reports by a national bank in the event of known or suspected crimes and replace it with a regulation that amends the requirements of the ruling. The proposed rule references a new report form, eliminates a requirement to send a report to the bank's bonding company, and extends the time for filing reports of mysterious disappearances. The current reporting system (§ 7.5225) is unduly burdensome on banks and has limited practical utility to the government agencies involved. The proposed rule is intended to make report filing more efficient for the banks and more useful for law enforcement agencies in identifying patterns of criminal activity and apprehending persons who commit crimes involving national banks. The proposed rule also clarifies the responsibilities of national banks in reporting and maintaining records of known or suspected crimes.

DATES: Comments must be received on or before October 28, 1985.

ADDRESSES: Comments should be directed to: Docket No. 85-14 Communications Division, 5th Floor, 490 L'Enfant Plaza East, SW., Washington, DC 20219, Attention: Lynnette Carter. Comments will be available for public inspection and photocopying at the same location.

The collection of information requirements contained in the proposed rule have been submitted to the Office of Management and Budget (OMB) for review under 44 U.S.C. 3504(h). Comments specifically addressing those information collection requirements should be submitted to: Office of Management and Budget, 726 Jackson Place, NW., Washington, DC 20500, Attention: Desk Officer for the Office of the Comptroller of the Currency; and should also be directed to this Office at the above address.

FOR FURTHER INFORMATION CONTACT: Jane Rasmussen, Attorney, Enforcement and Compliance Division, Office of the Comptroller of the Currency, Washington, DC 20219, (202) 447-1818

SUPPLEMENTARY INFORMATION:

Background

The OCC is charged with safeguarding the safety and soundness of national banks and is responsible for ensuring that national banks apprise law enforcement authorities of any potential violations of criminal statuts. Employee fraud, abusive insider transactions, check kiting schemes, and the like, can be serious threats to a bank's security and undermine the confidence and trust that individuals and businesses place in the banking industry. The OCC's primary concerns are losses sufficient in size or number to impact the safety and soundness of the bank, crimes committed by bank officials, and the adequacy of the bank's security systems and internal controls. The law enforcement community is concerned with receiving prompt reports with sufficient information to determine whether the matter warrants investigation and prosecution.

A Working Group was formed in December 1984 to address problems and promote cooperation toward the goal of improving the federal government's response to white collar crime in federally-regulated financial institutions. The Working Group is composed of senior officials of the financial institution regulatory agencies and the Justice Department. Among the

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recommendations of the Working Group to improve the referral system for suspected bank fraud was the use of a uniform Criminal Referral Form for use by all federally-insured financial institutions and the regulatory agencies.

Purpose

This notice of proposed rulemaking is part of an effort by the OCC in cooperation with the other federal financial institution regulatory agencies and the Department of Justice, to enhance the effectiveness of methods of discovering and prosecuting fraud and other crime in financial institutions. The goal of this rulemaking is to enhance the information quality of criminal referrals, thereby making the referrals more useful, and to provide a standard format. These changes will facilitate the assessment and investigation of possible criminal matters, aid in the identification of patterns of criminal misconduct, and improve the OCC's ability to track the disposition of criminal referrals.

Current Requirements

The OCC's § 7.5225, which is proposed to be removed, requires that a national bank make an immediate written report to the OCC, to the United States Attorney, the Federal Bureau of Investigation, and to the bank's bonding company when known or suspected thefts, embezzlements, check-kiting operations, misappropriations or other defalcations or other criminal violations involving bank personnel or bank funds occur. Reports of mysterious disappearances of bank funds of $1,000 or more are also required. A bank is required to include the identities of persons suspected and the reasons for suspicion in the report. No standard format is prescribed and the quality and amount of information reported has varied widely. These differences and shortcomings have hampered the agencies in their law enforcement efforts.

OCC Proposal

Proposed § 21.11 requires that a national bank submit a Criminal Referral Form upon the occurrence or discovery of any known or suspected theft, embezzlement, check-kiting operation, misappropriation or other defalcation involving bank personnel or bank funds, and any other suspected criminal violation. Mysterious disappearances or unexplained shortages of bank funds or other assets of $1,000 or more need not be reported if they are due to errors which have been discovered and corrected within seven business days. The seven-day deadline allows the bank sufficient time to resolve most shortages, thereby eliminating unnecessary reporting.

The Criminal Referral Form has two formats—a short form (CC-8010-08) and a long form (CC-8010-09). It is estimated that the short form will be used for 95% of the reports submitted.

The short form requires a bank to report the basic facts of the suspected crime, the approximate date and dollar amount of loss, the type of crime (embezzlement, check kiting, etc.), a brief summary of the violation, the identity of any person suspected, and the location of the offices to which the report is being sent. An expanded and more detailed report (the "long form") is required when the amount exceeds $10,000, or for any loss involving a bank insider (i.e., executive officer, director, or principal shareholder).

Failure to file reports required by the proposed rule could form the basis for civil money penalties against the bank, its officers, and its directors.

If a question exists as to whether to report an incident, the OCC recommends that a report be submitted. For example, a customer's pattern of cash deposits of just under $10,000 would not trigger the currency reporting requirements of 31 CFR Part 103, yet may indicate the existence of a money-laundering operation. Additionally, banks are free to report any potential violation, regardless of amount, either to federal, state or local authorities, whenever a violation of federal or state law is suspected.

Banks are also encouraged to telephone the appropriate authorities in situations which dictate an immediate notification, such as when a witness or evidence is likely to disappear. In such cases, the referral is to be documented by completion of the referral form.

The proposed rule provides for an exception to the reporting requirements for robberies, burglaries, and non-employee larcenies. This exception is provided because of an existing recordkeeping requirement in § 21.5(c). Under 21.5(c), a national bank is required to maintain a record of each robbery, burglary, or non-employee larceny committed or attempted at any of its banking offices. The record may be a copy of a police, insurance or similar report, or the bank's own record. Nothing contained in the proposed rule is intended to alter or eliminate the recordkeeping requirements of § 21.5(c).

Prior to October 6, 1981, § 21.5 also required a national bank to report each such instance to the OCC on Form CC-9030-02. This reporting requirement was eliminated because the limited benefits obtained from such reports did not justify the reporting burden on banks. 46 FR 49104 (October 6, 1981). A national bank continues to be under an obligation to report robberies, burglaries, and larcenies to the appropriate law enforcement authorities.

How the Proposed Rule Differs From Current Procedure

National banks already report suspected crimes pursuant to § 7.5225. Proposed § 21.11 requires the use of a criminal referral form and provides a uniform method for reporting. It is estimated that the short form will take less time to complete than preparing an original letter in each case. While the long form calls for more information than formerly was required for insider crimes and for crimes involving amounts of $10,000 or more, recent statistics gathered by the OCC indicate that only about 4% of the reported crimes involved more than $10,000, and that a very small proportion involved insiders. Further, a bank usually needs to gather such information in order to make an insurance claim, or in due course to prepare for prosecution.

This proposed rule eliminates the requirement that a bank send a report to its bonding company. These reports are a matter of the contractual agreement between the bank and the bonding company.

This proposed rule allows banks up to seven days to investigate and resolve mysterious disappearances and unexplained shortages before they are reported. Mysterious disappearances and unexplained shortages are frequently caused by clerical errors which are discovered and corrected. If the bank's investigation reveals that criminal activity was involved, then the incident must be reported even if it has been corrected.

The title of proposed § 21.11 differs from that of § 7.5225 (removal proposed). The title "Defalcations by Employees" has been changed to "Reports of Suspected Crimes." The former title was too limited since activities which involve bank funds, such as check kiting operations, are embraced by the regulation whether perpetrated by outsiders or bank employees.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601) it is certified that this notice of proposed rulemaking, if adopted as a final rule, will not have a significant economic impact on a substantial number of small entities.

Executive Order 12291

The OCC has determined that this proposed rule is not a "major rule" and therefore does not require a regulatory impact analysis.

List of Subjects in 12 CFR Parts 7 and 21

National banks, Criminal referrals, Insider abuse, Theft, Embezzlement, Check kiting, Defalcations.

Authority and Issuance

For the reasons set out in the preamble, Parts 7 and 21 of Chapter I of Title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 7—[AMENDED]

1. The authority citation for 12 CFR Part 7 is revised to read as follows:

Authority: 12 U.S.C. 1 *et seq.*

§ 7.5225 [Removed]

2. Part 7 is amended by removing § 7.5225.

PART 21—[AMENDED]

3. The authority citation for 12 CFR Part 21 is revised to read as follows:

Authority: 12 U.S.C. 1 *et seq.*, 93a, 1818, as amended, and 1881–1884.

4. The title of Part 21 is revised to read as follows:

PART 21—MINIMUM SECURITY DEVICES AND PROCEDURES AND REPORTS OF CRIMES AND SUSPECTED CRIMES

5. Sections 21.0 through 21.7 are designated "Subpart A—Minimum Security Devices and Procedures".

6. The title of § 21.0 is revised to read as follows:

* * * * *

§ 21.0 Purpose and scope of Subpart A.

7. New Subpart B consisting of § 21.11 is added to read as follows:

Subpart B—Reports of Crimes and Suspected Crimes

§ 21.11 Reports of Suspected Crimes.

(a) *Purpose.* This subpart applies to known or suspected crimes against national banks. This subpart ensures that the appropriate parties are notified when unexplained losses and known or suspected criminal acts are discovered. Based on these reports, OCC maintains a data base for monitoring the types and extent of crimes against banks.

(b) *Report required.* A national bank shall file Criminal Referral Form CC–8010–08 or CC–8010–09 in accordance with the instructions on the form. Copies are sent to the OCC District Administrator for the bank's district, the nearest office of the FBI, and the U.S. Attorney for the bank's district. A report is required in case of:

(1) Any known or suspected theft, embezzlement, check kiting operation, misapplication, or other defalcation involving bank personnel or bank funds in any amount.

(2) Any known or suspected criminal violation of any section of the United States Code or applicable state statutes involving the affairs of the bank.

(3) Any mysterious disappearance or unexplained shortage of bank funds or other assets of $1,000 or more which is not located by the bank within seven business days.

(c) *Exemptions.* Robberies, burglaries, and nonemployee larcenies which are explicitly covered by the recordkeeping requirements of § 21.5(c) are exempt from the reporting requirements of this section.

(d) *Notification to Board of Directors.* The chief executive or other appropriate bank officer shall notify the board of directors not later than at their next meeting, of the filing of any report hereunder.

(e) *Penalty.* Failure to file reports may subject the bank, its officers and directors to civil money penalties.

Dated: July 23, 1985.

H. Joe Selby,

Acting Comptroller of the Currency.

[FR Doc. 85–20448 Filed 8–27–85; 8:45 am]

BILLING CODE 4810–33–M

FDIC
Federal Deposit Insurance Corporation
Washington DC 20429

Division of Bank Supervision

April 14, 1986

Honorable Fernand J. St Germain
Chairman, Committee on Banking, Finance
and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

In your March 27, 1986 letter, you asked that we provide a written report updating your Committee on FDIC's efforts to improve the enforcement of Bank Secrecy Act (BSA) regulations and other matters since January 1, 1985. Our report is attached. We have provided itemized responses to the questions presented in your letter and have included several exhibits and attachments.

In April of last year, we reported that the publicity given the BSA in the wake of the Bank of Boston incident had heightened the awareness of the banking industry. Since then, a dozen or so other banks and banking companies have been heavily fined for failing to comply with the law, prompting the banking industry to respond with numerous educational programs designed to aid banks in complying with BSA regulations and to avoid the costly fines being handed out by the Treasury Department.

The FDIC and the other bank regulators have responded in similar fashion. In 1985, FDIC's training program on BSA compliance was completely revised. The new program focuses more on the "big picture" to give examiners an understanding of, and appreciation for, the use of Currency Transaction Reports (CTRs) as investigative tools to combat money laundering and drug trafficking.

The interagency examination procedures have just been revised and are awaiting Treasury's approval. While it is generally agreed that the examination procedures have, on balance, been effective in determining failures in the internal policies and procedures of financial institutions, recent history, i.e, the large-scale failures of some major banks to comply with the currency reporting requirements, suggested that certain modifications to the basic procedures needed to be made. The new procedures emphasize, among other things, international transactions, wire transfer operations and trust department activities. Examiners are instructed to more closely review exempt lists, interview bank employees concerning BSA procedures, and look for unusual currency flows. The new procedures also require examiners to keep better workpapers.

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We have included updated information on violations in Exhibit I. Overall the percentage of banks in violation of the currency reporting or exempt list requirements continues to increase. The impact of this trend, however, must be qualified by the effect of the FDIC's strategy--evident in the last three years--of directing its examination resources to banks exhibiting problems and lengthening the period between examinations of well-managed banks. Under this strategy, fewer banks have been examined each year, and because more of them have problems, we would expect the data to reflect a greater percentage of noncomplying banks. This fact is even more pronounced in 1985 as greater demands have been placed on our examining resources in the safety and soundness area. Despite this unfavorable trend, the FDIC's regional specialists generally point to overall improvement in compliance levels and consider trends in compliance to be encouraging.

As we have pointed out in the past, our supervisory practices and examination procedures cannot assure day-to-day compliance with bank procedures and the currency reporting requirements. The banks themselves must install the appropriate controls and audit procedures to detect violations and prevent abuses. The banking industry has shown a willingness, particularly in the last fourteen months, to assume a greater responsibility for compliance with the BSA regulations. Even with a greater commitment from the banking industry, however, corrupt bank employees will continue to subvert internal controls and avoid detection by bank examiners. As outlined in the attachments, bank regulators are communicating and cooperating more effectively than ever with law enforcement officials to achieve the optimum government response to criminal activity and insider abuse.

Sincerely,

for Robert V. Shumway
Director

Attachments

Report to the Subcommittee on Financial Institutions
Bank Secrecy Act and Financial Institutions
Regulatory and Interest Rate Control Act of 1978,
Titles I, VI and XI

1. Question:

The number of institutions examined by your agency since January 1, 1985 and the number and type of violations of the BSA found at these institutions, and actions taken by your agency on these violations.

1. Answer:

The information in Exhibits I and II updates the data supplied in April 1985. Generally, the 1985 information continues the trend established in preceding years. That is, a greater percentage of banks that are examined for BSA compliance are cited for one or more currency reporting or exempt list violations. The number of banks receiving BSA reviews decreased again in 1985 reflecting the tremendous demand being placed on FDIC's resources in the safety and soundness area and FDIC's strategy to focus examination resources on problem banks. Thus, the decreasing numbers of BSA examinations represent a greater percentage of problem banks and banks targeted specifically for potential BSA problems. For these reasons, the trend reflected in this report might not be representative of all FDIC supervised banks. A poll of our regional compliance specialists again reveals that the great majority of the violations on which the statistics in Exhibit I are based represent inadvertent failures to follow bank procedures and incomplete or late filings rather than actual failures to file.

2. Question:

Describe the training programs given to your examiners in BSA techniques and procedures. What improvements, if any, have been made since January 1, 1985?

2. Answer:

FDIC currently employs a three-pronged approach to BSA training. A formal program in Washington, Regional training updates and on-the-job training. Each examiner who is expected to be involved in a compliance examination is required to attend the FDIC's compliance school in Washington. This school includes a two-hour session on BSA compliance that was completely revised in 1985. The new session focuses on the rationale for, and the use of, CTR reports in combatting money laundering, drug trafficking and other criminal endeavors. Lesson plans and course material are included in Exhibit III.

Training at the regional level was added in 1985 to reach a larger number of examiners and to keep them up to date. Examiners are also kept informed of changes in examination procedures and interpretations of the regulations through Regional Office Directives and are encouraged to attend and actively participate in BSA seminars and training programs sponsored by banking groups and other organizations.

3. Question:

Describe efforts your agency has undertaken to improve communication with law enforcement agencies. What legal or policy impediments still exist that interfere with an open communication between the agency and law enforcement officials. Are they justified, in your opinion?

3. Answer:

On April 2, 1985, an interagency agreement was signed by the Attorney General, the Director of the FBI and officials of the financial institutions regulatory agencies. The agreement was intended to address problems and promote cooperation toward the goal of improving the federal government's response to white-collar crime in the nation's financial institutions. The major points of the agreement are as follows:

- Revise the criminal referral process;
- Improve coordination, cooperation and information sharing among the Working Group representatives;
- Develop an information system to track significant criminal cases;
- Improve, coordinate and share training resources relating to white-collar crimes involving financial institutions;
- Seek clarification of the Right to Financial Privacy Act and the Bank Bribery Act; and
- Meet on a regular basis to address problems and to share information on specific criminal cases.

A Working Group, formed under the agreement meets monthly in order to share information and address problems of common interest. To promote better communication, the FDIC has done the following:

(1) Supplied all regional offices and field offices with the names and phone numbers of contact persons in local FBI offices and U.S. Attorney offices. Conversely, U.S. Attorneys and FBI agents have been given corresponding FDIC contacts;

(2) Meetings have been arranged by FDIC regional officials to get acquainted with FBI and DOJ officials in their respective areas. In some parts of the country, representatives of the banking agencies, FBI and DOJ meet periodically to discuss criminal referrals and to exchange information and ideas on how to prevent and combat fraudulent activity;

(3) Joint FBI-Bank Examiner training sessions have been organized. Three have already been held in various parts of the country with two more scheduled in 1986. These sessions have proved to be extremely valuable in bringing together FBI agents and bank examiners who work in the same localities. Personal contacts are made at these sessions, and agents and examiners gain a better appreciation of each other's responsibilities and functions;

(4) Each agency has installed or plans to install a computer system to track criminal referrals. In addition, the Criminal Division has agreed to track major cases and to provide frequent and substantive feedback to the referring agencies. With these management information systems at their disposal, each agency will be able to frequently and systematically receive feedback or provide new information relevant to the criminal cases being tracked. The systems will also have the capability to spot trends, geographic patterns and emerging problems;

(5) The FDIC's regulation requiring banks to report criminal violations on a specific form will become effective shortly. Most banks are reporting on the new forms even though they are not yet required to do so. The new reporting system provides for personal contact between the reporting entity, either the bank or the FDIC, and the U.S. Attorney's office or the FBI. Here again channels of communication are opened and/or strengthened. To emphasize this point, the American Bankers Association, prompted by the regulatory requirements to report suspected crimes, has asked that its member banks be given the points of contact in local FBI and U.S. Attorneys offices that have been provided to the financial institutions regulatory agencies;

(6) The FDIC actively participates in the activities of the Bank Fraud Working Group. The group is compromised of representatives from DOJ's Fraud Section, FBI, FDIC, OCC, FHLBB, FRS, NCUA and a recent addition, the Farm Credit Administration. All of FDIC's operating components are represented at the group's meetings: the Division of Bank Supervision, Division of Liquidation and Legal Division, both open and closed bank sections. The Working Group meetings provide a forum for exchanging information and ideas. Bank regulators can bring to the attention of the Fraud Section and the FBI any criminal or fraudulent activities that are occurring in the banking industry. They can also appeal to the Fraud Section for assistance or intervention in cases that are important to regulators but, for various reasons, might not be receiving vigorous prosecutive attention. Because each participating member of the group represents a powerful contact point in his/her respective agency, the group's most useful function may be as a vehicle to get things accomplished quickly and effectively. We have been very encouraged by the achievements of the Working Group to date. While tangible results have already been noted, the real impact is yet to come as the Group's objectives are realized and its programs are implemented.

In an attempt to emulate the success of the Bank Fraud Working Group, with its focus on Title 18 of the U.S. Code, another interagency group focusing on BSA compliance and money laundering was formed in 1985. This group is chaired by a representative of the Treasury Department and includes IRS, FDIC, OCC and FRS. One of the group's primary objectives was to revise the Bank Secrecy Act examination procedures. A finished product was recently submitted to Treasury for final approval.

Another group, chaired by IRS, meets monthly. This group is comprised of representatives from IRS, FDIC, OCC, FRS, FHLBB, NCUA, Treasury, Customs and SEC. The objectives of this group are to improve communications among the participating agencies and to resolve difficulties that arise in enforcing BSA regulations. These meetings provide a good forum for informing the civil enforcement agencies of the current thinking at Treasury and of recent developments in criminal cases. IRS's Criminal Investigation Division is an active participant. At a recent meeting, a presentation on evidentiary matters relating to BSA prosecutions was made by DOJ's Narcotics and Dangerous Drugs Section.

4. Question:

Describe the progress, if any, that has been made between your agency and the Federal Reserve regarding the type of currency shipment reports that are made available by the Fed. Has your agency made use of such reports? Be specific.

4. Answer:

At this time there is no direct transfer of currency shipment reports from the Federal Reserve to the FDIC; however, FRS supplies this information to the Department of the Treasury (U.S. Customs Service) where it is correlated with information from CTRs. The objective of this analysis is to identify banks that exhibit the characteristics of money laundering. Analytical reports prepared by Customs are then given to FDIC and passed along to respective regional offices for further review and follow-up. Each analysis identifies banks in a specific geographical area that have filed no CTRs or have filed fewer CTRs than banks of similar size. Each bank so identified is targeted by FDIC for a special BSA compliance review at the next regular safety and soundness or compliance examination. If no regular examination is scheduled in the next six-months, a special visit is considered. We are strong supporters of this type of analysis for it permits us to more effectively target institutions for BSA examinations.

5. Question:

Describe the management controls over implementation of BSA responsibilities that were in place before January 1, 1985 and changes, if any, since that time.

5. Answer

Each FDIC regional office has designated at least one person to be responsible for reviewing BSA compliance examination reports and for initiating any follow-up of apparent violations contained therein. This system has proven effective in the past and no changes are contemplated. The same regional official is responsible for reviewing and processing criminal referrals and recommendations for civil money penalties that are generated as a result of BSA compliance reviews. Aggressive follow-up action is taken to ensure that

CTRs that were not filed as of our examination date are ultimately filed with the IRS and we attempt to ensure future compliance by requiring periodic progress reports from the bank on its compliance efforts. Examiner visitations and follow-up examinations are scheduled where appropriate. Continued noncompliance may result in a memorandum of understanding, a recommendation to Treasury for civil money penalties or initiation of a Cease and Desist Order.

6. Question:

Describe the initiatives your agency has taken to broaden the knowledge of and exposure to reporting requirements of the BSA for those institutions you regulate.

6. Answer:

The FDIC uses the Bank Letter, a formal communication distributed to all State nonmember banks and insured savings banks, to inform the banking community of current developments in BSA compliance. Bank Letters address changes or amendments to the regulations as well as any changes in the reporting forms and instructions. The FDIC also maintains open lines of communication with the banks that it supervises. Banks often call in questions regarding BSA matters. Sometimes these calls result in leads to possible money laundering activity.

Besides informing banks of changes to the BSA regulations, reporting forms and any other important developments, FDIC holds regional compliance seminars covering consumer laws and the BSA regulations. Banks located in the FDIC regions hosting the program are invited to attend. We also encourage FDIC examiners to address bankers' groups and employee organizations on BSA matters. In 1985, the FDIC assisted in producing a program sponsored by the American Bankers Association (ABA) to educate bankers on money laundering and Bank Secrecy Act compliance. The program, a one-day pretaped video teleconference, was shown at 61 sites throughout the country. The teleconference was well received by the banking community and brought forth about 5,000 questions from the attendees.

7. Question:

Describe the role your agency played in the Attorney General's Bank Fraud Working Group. Cite specific examples on how your agency has implemented that agreement.

7. Answer:

The FDIC's Legal Division and Division of Bank Supervision were involved from the start in the Attorney General's Bank Fraud Working Group, as drafters of the agreement and later as working members of the group. The FDIC's Division of Liquidation became involved after the agreement was signed. As early as

July 1984, well before the formation of the interagency working group, FDIC recognized the need to improve relations with law enforcement officials. Citing the presence of fraud as a significant factor in many bank failures and the increasing number of criminal referrals emanating from FDIC-supervised banks, on July 20, 1984, the Division of Bank Supervision issued a directive to its Regional Offices asking for the designation of a contact person in each office to reinforce channels of communication with U.S. Attorneys offices and the FBI. These contact persons were encouraged, at that time, to arrange get-acquainted meetings with law enforcement officials. As the points of agreement were being developed and subsequent to the signing and public announcement of the agreement, the FDIC took the following actions:

(1) In January 1985, FDIC examiners were officially informed of the enactment of the new bank fraud statute, 18 U.S.C. 1344, and the revision of the Bank Bribery Statute, 18 U.S.C. 215. They were instructed to begin citing these statutes in criminal referrals;

(2) In March 1985, FDIC redefined its policy and issued a directive to clarify the type and amount of information that could be disclosed to law enforcement officials in connection with criminal referrals. The directive also encouraged greater personal contact and information sharing between examiners and FBI agents;

(3) Also in March, FDIC provided its regional offices with the names of contact persons in U.S. Attorneys offices and local FBI offices. Regional Officials were again directed to meet with the law enforcement officials named as contacts in their regions. Updated lists are provided periodically;

(4) In May 1985, Regional Offices were given copies of the Points of Agreement adopted by the interagency group and again directed to work to improve channels of communication;

(5) In October 1985, FDIC proposed a new regulation requiring the banks it supervises to report suspected criminal activity on the form adopted by the working group. Forms were mailed to banks and they were encouraged to use them even though not yet required to do so.

(6) In November 1985, a workshop was held in Washington for regional personnel who would be responsible for making and reviewing criminal referrals under the new system;

(7) In December 1985, FDIC examiners were instructed to begin referring criminal violations on the newly adopted form; and

(8) In March 1986, FDIC sponsored an interagency school in San Francisco on white collar crime. One of the objectives of the school was to improve cooperation between bank examiners and FBI agents. This session was one of the five sessions put on by the FBI and sponsored by the member agencies of the Working Group.

Also in keeping with the agreement, FDIC has developed a computer system to track criminal referrals and to provide status reports to the initiating regional and field offices. FDIC's regulation requiring banks to report suspected crimes is expected to be adopted within the next week or two. Most banks are already reporting on the new form. FDIC is participating in the development of an FFIEC school on white collar crime that will become a permanent source of training for FDIC bank examiners. In short, FDIC is complying in every aspect with the points of agreement. We view the agreement and the commitment it represents to be a major turning point in the government's response to white collar crime and insider abuse in the nation's financial institutions.

8. Question:

Submit copies of all revised regulations, banking circulars, newsletters, internal communications, updates to the manual for examiners, and any other written information pertaining to enforcement efforts of the BSA undertaken by your agency since January 1, 1985.

8. Answer:

Attached and labeled Exhibit IV are copies of various Regional Director Directives, Bank Letters, and rule interpretations issued by the Treasury Department that were distributed since January 1, 1985. Presently one Bank Letter is in process concerning banks' requests for special exemptions for customers believed to warrant exemption from the currency transaction reporting requirements of the regulation, and one Regional Director Directive is in process concerning examiner review of the banks' copies of CTRs.

Title I (Supervisory Authority Over Depository Institutions)

In 1978 Congress gave banking regulators authority to impose civil money penalties for violations of laws, rules and orders. The new authority gave the agencies the flexibility they needed to impose penalties on individuals or institutions for violations which did not rise to a criminal violation.

A. Question:

Specifically, is there any merit to considering giving the regulators authority to impose civil money penalties upon financial institutions for their failure to report under BSA, or should the Treasury continue to have the authority to impose such penalties?

A. Answer:

We doubt that significantly better use of civil money penalties (CMP) would be made by bank regulators if given such authority without first addressing the fundamental problem implicit in the BSA regulations. As presently written, the regulations do not clearly differentiate between criminal and civil violations. The standards are essentially the same. If a violation is committed willfully it can be pursued under either civil or criminal guidelines. Each FDIC referral to the Department of the Treasury regardless of whether we cite apparent civil or criminal violations, is first evaluated to determine whether potential criminal violations exist. If the evaluation indicates possible criminal violations, Treasury authorizes a criminal investigation. If not, the merits of a civil proceeding are assessed.

Although the interagency guidelines permit FDIC to recommend civil money penalties where there is evidence that violations were committed with a continuing disregard for the law, where violations have not been corrected or where the bank fails to show good faith in cooperating with the FDIC to correct violations and to install proper systems and procedures, in practice, Treasury has not pursued CMPs on these bases. We believe the willfulness test in Section 103.47 (31 C.F.R. § 103.47), which is as we stated above is almost identical to the criminal standard, substantially precludes the effective use of CMPs to correct continuing violations due to improper procedures and recalcitrant bank officials. We would suggest amending 31 CFR § 103.47 by adding the phrase "or continuing disregard of the law" (or similar language).

B. Question:

To what extent could these powers be improved upon to lend support in appropriate cases to criminal law enforcement investigations?

B. Answer:

It is Treasury's current practice to request the bank regulatory agencies to suspend all civil enforcement efforts relating to BSA compliance, including examinations, when a criminal investigation has been authorized. Because of this practice, banks that have been identified as having problems with BSA compliance can escape BSA examinations while the criminal proceeding is ongoing, resulting in continuing noncompliance during that period and leaving the supervisory agency uninformed about BSA practices in the bank. Such information can be crucial to our regulatory process in acting on applications, changes in control, etc.

The separation of civil and criminal processes in connection with BSA enforcement is contrary to the approach taken by the Bank Fraud Working Group with regard to violations of Title 18 U.S.C. and probably results from the BSA's virtually identical standard for both civil and criminal violations. If civil and criminal proceedings were permitted to move on two tracks, simultaneously, information developed on the civil side might prove helpful in the criminal investigation. In any case, the bank would not be allowed to continually violate the law while the criminal case is unfolding.

Titles VI and VII (Change in Bank Control Act and Change in Savings and Loan Control Act , respectively)

A. Question:

What modifications, if any, do you feel are necessary to deny acquisitions of control to unqualified or dishonest individuals?

A. Answer:

On March 24, 1986, the FDIC revised its policy of confidentiality for notices filed under the Change in Bank Control Act of 1978 (CBCA). The amended regulation requires a person who has filed a notice of proposed acquisition of control with the FDIC to publish in a local newspaper an announcement of the FDIC's acceptance of the notice. The regulation also makes certain information regarding accepted CBCA notices available to the public upon request.

The revised policy requiring newspaper publication and authorizing public disclosure is designed to increase the amount of timely and useful information available to the public and to increase the FDIC's sources of information in connection with its statutory review of acquisitions and changes in control, thereby enhancing the FDIC's ability to carry out the purposes of the CBCA, namely, to prevent dishonest or unqualified persons from acquiring control of federally insured banks.

The newspaper publication would invite comment by the public, for a twenty-day period, and would, we believe, bring to our attention, relevant information about the proposed acquirors that under our previous confidentiality policy may not have become known to us until the transaction had been consummated.

There are two other areas where the CBCA could be modified. First, transactions which are subject to Section 3 of the Bank Holding Company Act of 1956 (12 U.S.C. 1842) are not subject to the Change in Bank Control Act. In certain cases, the applicability of the Bank Holding Company Act depends on a determination by the Board of Governors, after notice and opportunity for hearing, that a company has power, directly or indirectly, to exercise a controlling influence with respect to management or policies of a bank. (Section 2(d), 12 U.S.C. 1841(d)). Pending proceedings by the Board of Governors should have the effect of staying the time within which the FDIC may act under the Change in Bank Control Act.

Second, the Change in Bank Control Act (12 U.S.C. 1817(j)(15)) provides for civil penalties for violations, but there is no specific provision for divestiture or prohibiting an acquiring party from exercising control if stock was acquired in violation of the Act. Specific authority authorizing such actions would promote enforcement of the Act.

B. Question:

Should more specific standards regarding what constitutes sufficient integrity or criteria used to determine what would not be in the best interest of the depositors or the public, be included by statute or imposed by regulation?

B. Answer:

Under the CBCA, regulatory agencies are empowered to impose a rather severe penalty on an individual. A disapproval of a CBCA Notice effectively precludes a person from exercising ordinary property rights with respect to ownership of an insured bank. A denial based on the factor of personal integrity is the most difficult to support and the most sensitive in terms of individual rights. A legislative definition of lack of integrity would facilitate administration of the Act. Any such definition should provide discretion to the FDIC (and other agencies) to make findings in cases not specifically covered by the definition. We would be pleased to work with this Committee in developing a proposal. Better definition by regulations is an alternative to legislation and we are studying the approach taken by the Federal Home Loan Bank Board. At this time, however, we are not in a position to make any formal suggestions or recommendations.

C. Question:

Should the agency be given more time in which to disapprove an application for change of control (currently within 60 days, not to exceed 90 under certain circumstances)?

C. Answer:

Generally, the time limits included in the CBCA are adequate to permit FDIC to properly exercise its responsibility. We would, however, support an extension of time based on specific criteria, one of which might be to assure compliance with BSA regulations as proposed in H.R. 3892. Additional time might also be appropriate to fully assess the impact of a criminal investigation or indictment on the competence and integrity of a proposed acquiror or to complete background investigations of foreign nationals.

D. Question:

What is the standard used for the term "willful" under the Act? Does this definition create problems for the agency? If so, what are they?

D. Answer:

The problem we encounter with the term "willful" as used in the CBCA is whether it relates to a person's intent to acquire control in a bank or intent to violate the statute. More difficulty is encountered in attempting to show that a proposed acquiror acted willfully and "in concert" with others to violate the statute. Better definition of these and other terms used in the CBCA is certainly desirable.

E. Question:

What problems, if any, is the agency incurring in obtaining sufficient relevant information of foreign nationals seeking to acquire U.S. depository institutions?

E. Answer:

We encounter several problems when attempting to verify the backgrounds of foreign nationals proposing to acquire insured State nonmember banks. First, no central file of arrest and conviction records exists, so we are required to check with a number of agencies. In addition to the FBI, we routinely check with Interpol, CIA, and Customs; and check with the State Department, DEA and other agencies if circumstances indicate they might have records.

Second, background checks with many of these agencies cannot be completed within the sixty day time period allowed under the law. The third problem is that information, when located, is often not of the substance and quality needed to support a disapproval. We are open to suggestions from law enforcement agencies on how to proceed in this area and would welcome an initiative to improve the system currently in place.

Title XI: Right to Financial Privacy Act (RFPA)

There is no question that the Right to Financial Privacy Act has impeded the flow of information from banks and bank regulators to federal law enforcement agencies. The Act represents both a legal and psychological barrier that impedes the successful investigation and prosecution of financial criminals. Its dysfunctional impact, we believe, reaches well beyond the legitimate privacy concerns that Congress intended to protect. As we see it, the Act's major flaws are as follows:

(1) Psychologically, the Act has created the perception in the public's mind that Congress is more concerned about the privacy of individuals, including potential criminals, than it is about effectively enforcing criminal violations against financial institutions. This factor, among others, has contributed to the lack of an effective deterrent in recent years to would-be financial criminals.

(2) The Right to Financial Privacy Act has had a troubled and confusing history. Conflicting interpretations of its meaning and reach abound. As an example, each of the federal financial institutions regulatory agencies holds a different opinion on how the Act should be applied to criminal referrals. At a minimum, the Act should be revised to clarify, once and for all, the intent of the Congress.

(3) The Act, as interpreted by most interested parties, extends the customer-privacy protections to bank insiders by virtue of the fact they are often also customers of the bank. Insider abuse of federally insured financial institutions is unquestionably a major cause of bank failures and of losses to the FDIC's insurance fund. We believe that insiders, by virtue of their position in federally

insured institutions, ought to be treated differently than customers. We further believe that Congress did not intend the RFPA to protect insiders to the same extent as customers. We have repeatedly recommended the Act be amended to correct this flaw.

(4) The requirement to notify customers whose accounts have been manipulated by an insider represents another flaw in the way the RFPA is being administered. Where a customer is not a target of an investigation, but rather a potential victim, notification can be unduly alarming to the customer.

(5) The Right to Financial Privacy Act also impedes the transfer of information contained in reports of examination to federal investigative agencies having a legitimate need for the information. From the FDIC's perspective, transfers to the SEC, CFTC and IRS are most often affected. As an example, the RFPA requires notification to customers whose names appear in an examination report if the report is shown to another government authority. SEC has a lawful interest in investigating the improper public disclosure of loan losses to bank investors. IRS has a lawful interest in investigating loan losses to determine proper tax treatment. The names of classified or charged-off borrowers in an examination report are very helpful in these types of investigations. Under the RFPA, FDIC either must notify people whose loans were cited in the report (if they can be located) or render the transferred information unidentifiable as to a particular customer. This process is time consuming and impedes legitimate inquiries where the bank is the target of the investigations, not the customers.

The amendments to the RFPA contained in H.R. 2785 reflect the suggestions of the Bank Fraud Working Group on which the FDIC is represented. These amendments would correct the flaws in the RFPA mentioned above and would free financial institutions from the restrictions and uncertainties now affecting their ability to make informative criminal referrals. We strongly urge the Congress to adopt these amendments.

TAX EVASION, DRUG TRAFFICKING AND MONEY LAUNDERING AS THEY INVOLVE FINANCIAL INSTITUTIONS

THURSDAY, APRIL 17, 1986

House of Representatives,
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance,
Committee on Banking, Finance and Urban Affairs,
Washington, DC.

The subcommittee met at 9:32 a.m., in room 2128 of the Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of the subcommittee) presiding.

Present: Chairman St Germain; Representatives Cooper, Kaptur, Wylie, McKinney, McCollum, and Wortley.

Also present: Representative Esteban E. Torres of the full committee.

Chairman **St Germain**. The subcommittee will come to order.

Yesterday, the subcommittee heard testimony from witnesses who described various money-laundering schemes in which financial institutions were used. The subcommittee heard how under certain circumstances the reporting requirements of the Bank Secrecy Act could be avoided by certain criminal elements in our society.

Today, we will hear from the Department of Treasury and the banking regulators who will report on regulatory actions taken since last April to ensure that the financial institutions of this Nation are in compliance with the reporting requirements and other provisions of the Bank Secrecy Act.

We are especially interested in learning how Treasury's negotiation procedures with banks charged with civil violations of the reporting requirements of the Bank Secrecy Act work; are they timely, effective, and are they a deterrent to future abuses?

In addition, the witnesses will also give us the benefit of their analysis of the legislative proposals dealing with money laundering that have been referred to the Banking Committee.

The question has been raised as to whether the Bank Secrecy Act, in and of itself, as important as that act is, fully addresses the grievous problems that currently exist regarding the use of financial institutions for the purposes of tax evasion, drug trafficking, and other money-laundering activities.

Therefore, the subcommittee will examine other banking statutes that may be of assistance. We look forward to the testimony of our witnesses today to help us in determining whether there is any merit to giving regulators additional civil money penalty powers to include the Bank Secrecy Act as another law which would be covered under their jurisdiction for civil enforcement.

The subcommittee will also explore whether the change in the Bank Control Act can be strengthened to help detect criminals who seek to obtain control of financial institutions.

At this time, we would like to have welcomed to the subcommittee Hon. Francis A. Keating II, who is the Assistant Secretary of the Treasury for Enforcement and Operations as our first witness today.

Is he here?

[No response.]

Obviously, he's enforcing or doing something exciting. He is on his way right now? Well, we're going to put the panel on because the hearing was scheduled to begin at 9:30. The chairman was here and I think Mr. Keating could have been here.

I will ask, therefore, the panel to approach the table: Mr. Woodard, Mr. Passarelli, Mr. Dudine, and Mr. Serino.

We welcome the panel. We will put your statements in the record and we will ask you to make your presentations at this point.

The first witness will be Percy P. Woodard, Jr., Assistant Commissioner for Examination of the Internal Revenue Service.

Mr. Woodard.

STATEMENT OF PERCY P. WOODARD, JR., ASSISTANT COMMISSIONER (EXAMINATION), INTERNAL REVENUE SERVICE

Mr. WOODARD. Thank you, Mr. Chairman.

I would like to summarize examination's role in supporting the Service's mission and provide a synopsis of our role under the Bank Secrecy Act and our efforts to use currency transaction reports to maintain voluntary compliance.

Examination's mission is to identify and cost effectively allocate resources to those returns in need of examination and to conduct quality examinations on those returns identified.

To accomplish this, we have a limited amount of resources which must be spread across a variety of returns, such as income, estate, gift, employment and excise taxes, and also a variety of tax abuse problems, such as tax shelters and tax protesters.

Since the early 1980's, our resources have remained fairly constant, while return filings have increased. The result has been declining examination coverage. Thus, the selection of those returns with the highest probability of noncompliance has become extremely important to maintaining the public's confidence in the tax system's integrity, fairness, and efficiency.

Before I discuss the importance of information required by the Bank Secrecy Act in accomplishing our mission, I would like to review the Service's responsibilities under the act.

The Service is responsible for ensuring compliance with the reporting and recordkeeping provisions of the act by any financial institution not under the regulatory supervision of Federal banking agencies or the Securities and Exchange Commission. These functions have been divided within the Service between examination, to perform civil compliance checks, and criminal investigation, for investigating criminal violations of the act.

Institutions under examination's jurisdiction for compliance checks include check-cashing services, if such services are a primary business, and other currency exchange operations, except coin dealers; issuers, redeemers or cashiers of travelers checks, money orders, or similar instruments; licensed senders or transmitters of funds abroad for others; telegraph companies which transfer funds domestically or internationally; licensed gambling casinos having gross annual gaming revenue in excess of $1 million; and the domestic branch, agent, or agency of a foreign bank which is not supervised by one of the Federal banking agencies, such as a law firm acting as an agent for a foreign bank.

As a result of Treasury Order 105-13, examination also has responsibility for enforcing the civil aspects of the exemption provisions of the Bank Secrecy Act.

In addition, we have responsibility for assuring compliance with the filing of currency transaction reports—for those banks not currently examined by any of the other Federal supervisory agencies—for safety or soundness, such as State chartered banks, savings and loan associations, or credit unions.

Compliance checks are necessary to ensure integrity with the filing requirements. However, another real benefit to be derived from currency transaction information will be their use in identifying returns in need of examination for those who are not complying with the income tax requirements. In this sense, a major role of the examination function is as the end-user for all of the information generated by this act.

Therefore, examination is studying how best to utilize currency transaction information and our efforts can be described as a multilevel approach.

First, we have placed in process a system that associates currency transaction information with the tax returns that are selected for examination and with the returns that are part of our information document-matching program.

Next, and, I might add, a much more difficult part of the process, is to develop a selection system that effectively uses this information to cause returns to be examined.

Therefore, we must be able to discriminate among the large volume of these reports to identify those that have the greatest potential for noncompliance.

Before I describe some of the studies that we have undertaken to do this, let me say that it is difficult to use the CTR as the sole indicator of noncompliance, although it may be a very vital piece of information with respect to a particular case.

Our research efforts in this area have taken a novel approach in trying to solve this problem and to build a return selection system.

Traditionally, we have approached building return selection systems using data that appears on filed income tax returns. The studies which I am about to describe focus not only on tax return information, but in a significant way, they also focus on information not appearing on the tax returns and the CTR and the CMIR's are components of that nonreturn information.

We have a Florida tax haven study which is attempting to establish a profile of individuals involved in money laundering so that we can build from this profile a supplemental selection system. Data for this study is being drawn from cases in south Florida involving a major money laundering scheme.

The case involved a Florida tax preparer arrested for various currency and narcotics violations. As a result of that arrest, a large volume of client files and related information was acquired by the Internal Revenue Service. A preliminary reconstruction of income using currency monetary instrument reports [CMIR's] that were filed by this preparer indicates more than $38 million was laundered by his office through a tax haven and returned to Florida during 1982 and the first 5 months of 1983.

Examinations of clients to date indicate that two basic laundering schemes were utilized. One of the methods used involved the physical delivery of cash to the local agency of a foreign bank for the purpose of wiring these funds to a foreign country. Wiring funds, however, established a paper trail due to the Bank Secrecy Act reporting requirements.

Therefore, to circumvent this, in a majority of the cases, the preparer personally transported the cash in a chartered plane to the tax haven country. Of course, this represents noncompliance with the CMIR provisions which should have been reported to the Customs Service.

Data was collected from the examination of those clients who had failed to report part or all of their income. Of approximately 135 cases closed to date, examiners have discovered more than $49.5 million in unreported income and proposed in excess of $37 million in additional tax and penalties.

CTR's were used in conjunction with other sources of information, such as CMIR's and bank records, to uncover about $16 million of the unreported income. However, the CTR's alone accounted for less than $500,000 of the unreported $16 million.

This indicates that CTR's are a valuable tool when used with other information sources. The CTR alone in many of these cases did not assure that the person was an underreporter or that the amount represented unreported income.

We are now attempting to use data from the study to identify individuals who possess the same characteristics as those found to be concealing income in the Florida case. This would give the Service an additional return selection system for identifying returns in need of examination.

The tax haven offshore banking project has been established jointly by the examination and criminal investigation functions to consolidate the various types of third-party information which is associated with tax haven activity. Data from this project will be used to select cases for a controlled study which will evaluate and combine information from third-party sources, including CTR's, to test the effectiveness of this technique in identifying non-compliance.

Other cases will be referred to the field as the result of civil leads provided to examination by the criminal investigation division. These leads will be tracked and the results analyzed to detect common patterns of money-laundering techniques. These efforts are still ongoing and we are not yet certain how well they will work for us.

Finally, I would like to point out an inconsistency between the summons authority available under title 26 and title 31 which does have an impact on our ability to enforce title 31.

Presently, we cannot honor the financial institutions' requests for a summons in connection with a compliance check, nor can we summons or subpoena records from an institution that refuses to cooperate. Cooperating financial institutions frequently request a summons as a means of protecting themselves from possible suits by their clients.

In title 26 examinations, we issue such a summons to the requesting bank. Without such authority under title 31, institutions who really want to cooperate with the Service refuse to do so for their own legal protection.

Furthermore, if we are conducting a title 31 examination and a financial institution refuses to provide us with appropriate books and records to reach a determination, we have to stop our examination and forward that incomplete case to Treasury for appropriate action. We feel that this is wasteful of our resources and is not administratively effective.

In summary, the real benefit to be derived from the information required by the act from the standpoint of civil tax enforcement is the use of that data in identifying returns in need of examination. I hope I have emphasized the extent of examination's efforts in developing a selection system using Bank Secrecy Act information as an integral part of our efforts to improve voluntary compliance.

I would like to thank the subcommittee for permitting me to provide this information.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Woodard can be found in the appendix.]

Chairman St Germain. Thank you, Mr. Woodard.

Now we will hear from Francis M. Passarelli, who is the Acting Director of the Office of Examination and Supervision, with the Federal Home Loan Bank Board.

Mr. Passarelli, we will put your entire statement into the record. You may proceed.

STATEMENT OF FRANCIS M. PASSARELLI, ACTING DIRECTOR, OFFICE OF EXAMINATION AND SUPERVISION, FEDERAL HOME LOAN BANK BOARD

Mr. Passarelli. Thank you. Mr. Chairman and distinguished members of the subcommittee, I am Francis Passarelli, Acting Director, Office of Examinations and Supervision of the Federal Home Loan Bank Board.

Accompanying me are Harry Quillian, Acting General Counsel of the Bank Board, and Rosemary Stewart, Director of the Board's Office of Enforcement.

We are here today to testify on the Board's effort to carry out its responsibility under the Bank Secrecy Act, which I will sometimes refer to as BSA. The Board recognizes the importance of this act and in my testimony I will discuss both our BSA activities and our plans to strengthen them. I will then address issues the subcommittee raised with regard to other laws and proposed legislation.

One of the principal ways that we have carried out our Bank Secrecy Act responsibilities is by having our examiners review compliance with the act in their regular examinations. Our Bank Secrecy Act examination objectives and procedures were developed with other Federal financial regulatory agencies, the Treasury Department and the Government Accounting Office.

In 1982, in order to focus our limited examination resources on the most urgent targeted areas, mandatory usage of the EOP was suspended. But the EOP, examination work papers and BSA check list remain the principal guidance to examiners. Examiners continue to be responsible for meeting examination objectives.

Whenever necessary, examiners must advise institution managers of their responsibilities under the BSA regulations. The Board's supervisory agents at the 12 Federal home loan banks are responsible for taking supervisory action when necessary to obtain compliance with the act.

We refer violations that warrant civil or criminal penalties to the Treasury Department as soon as they are discovered by bank system examiners. In addition, we transmit summary reports of all violations twice a year to the Treasury Department.

Moreover, pursuant to the BSA and its regulation, OES may recommend to the Treasury Department that it impose civil penalties and make referrals for possible criminal investigations.

In 1985, we found 46 Bank Secrecy Act violations in a total of 10 of the 1,808 institutions we examined. Forty violations concerned failure to file currency transaction reports and six concerned failure to maintain the required list of exempt customers.

In all cases, we required corrective action. In one instance, we referred the matter to Treasury with a recommendation for a civil penalty and criminal investigation.

We hope that the small number of violations that we have detected in our examination process indicates that most institutions we regulate comply with the Bank Secrecy Act. However, we are taking action to strengthen our examination and supervisory process in general, and those relating to——

Chairman St Germain. Excuse me. Mr. Passarelli, I hope you're going to do more than hope.

Mr. Passarelli. We intend to, sir.

Chairman St Germain. That's a pretty weak word.

Mr. Passarelli. We intend to, sir. I would like to tell you some of the actions we've taken and are taking.

Because the Bank Board recognized that its examination staff was too small to handle the increased demands we have recently faced, on July 6, 1985, the Board transferred its 747 examiners to the 12 district banks and gave the banks responsibility for conducting examinations under policies and procedures established by the Board.

Following this reorganization, the Federal home loan banks expanded their examination staffs at the direction of the Federal Home Loan Bank Board Chairman Gray

By December 31, 1985, there were 1,003 examiners in the banks, a more than one third increase over the July 6 figure. Moreover, the Chairman's goal is to reach 1,250 examiners by July 1, 1986, which will be a total increase of two-thirds in 1 year.

To ensure that substantial and material violations of law are corrected promptly, the Chairman has repeatedly directed bank system staff to take aggressive supervisory action.

On August 9, 1985, he issued a memorandum requiring that supervisory correspondence to depository institutions be firm and precise, and that formal enforcement action be initiated where violations or unsound practices cannot be resolved expeditiously.

On August 23, 1985, the Chairman called for prompt, vigorous use of formal enforcement tools for material violations and deficiencies, and required reporting to Washington whenever such enforcement was not deemed immediately appropriate.

On February 12, 1986, he directed the immediate reporting of significant problems detected during examinations.

All new examiners are required to attend the new examination training school which includes instructions on the Bank Secrecy Act.

In addition, we have provided all 12 Federal Home Loan Banks with a videotape designed in part at the board. The videotape is intended for the newly hired examiner and as refresher training for examination and supervisory staff.

During 1985, and thus far in 1986, we have issued a number of notices about the Bank Secrecy Act to institutions in the Federal Home Loan Bank System, including memoranda describing the responsibility of independent public accountants under the Bank Secrecy Act; directing each institution to establish Bank Secrecy Act employee training programs; providing information on the new role of the Internal Revenue Service in reviewing exemption lists and approving or denying individual requests for exemptions; and distributing amendments to the Bank Secrecy Act regulations.

The Federal Home Loan Bank Board has worked closely with the Department of Justice to design a revised criminal referral form to obtain information the Department needs for criminal investigations.

In 1985, board examiners filed 150 of these forms and insured institutions voluntarily filed 652.

Beginning in 1986, FSLIC-insured institutions have been required to report known or suspected criminal acts. As a result, in the first 3 months of 1986, examiners filed 27 referral forms and the institutions themselves filed 911. The Bank Board has actively participated in the Attorney General's Bank Fraud Working Group and established contacts throughout the country to communicate quickly and directly with the Justice Department.

In addition, the Board is participating in the Justice Department's new tracking system for agency criminal referrals. In addition, we are revising our Bank Secrecy Act examination procedures. We are also writing Bank Secrecy Act supervisory procedures. We are also drafting additional guidance to help auditors detect and report money laundering activities and are distributing to the staff and to insured institutions several recent issuances from the Department of the Treasury.

Chairman St Germain. Mr. Passarelli, let me ask you this. You're aware of the GAO report to us.

Mr. **Passarelli**. Yes, sir.

Chairman **St Germain**. It stated that your examiners were given an option as to whether or not they would perform a Bank Secrecy Act examination to be done at their discretion.

Was that an accurate report by GAO?

Mr. **Passarelli**. Yes, sir.

Chairman **St Germain**. When did this policy change? With the Bank of Boston situation?

Mr. **Passarelli**. I think the emphasis came in August of 1986——

Chairman **St Germain**. In August 1985, I would think. If it was August of 1986, you'd have to have a crystal ball.

Mr. **Passarelli**. August 1985 and we actually strengthened our procedures in regard to the Bank Secrecy Act regulations.

Chairman **St Germain**. So that the Federal Home Loan Bank Board was somewhat akin to many of the banks that have since been fined. All of those banks that were fined had a cavalier attitude. Well, that's not really all that important.

Mr. **Passarelli**. Not necessarily, sir. I think what we've done is actually targeted the examination. I think the examiners, what they did, they limited the scope of their examinations and as a result of this limited scope, they didn't actually get into the details that were more——

Chairman **St Germain**. Well, the fact of the matter is they didn't do it. You know, you're giving some doubletalk here, but what it boils down to is it's fine to hear all of this and we're happy about it. However, for a long period of time, there was obviously an attitude that prevailed not only within financial institutions, but among some of the regulators.

Mr. **Passarelli**. Yes, sir. In fact, with the increased staffing that we're getting, we're going to expand our procedures in regard to this aspect of our examination, yes, sir.

Chairman **St Germain**. The fact of the matter is that up until 1985, when the lid came off, the Federal Home Loan Bank Board and its examiners weren't paying much attention to the Bank Secrecy Act and its reporting requirements.

Is that a fair statement?

Mr. **Passarelli**. Yes, sir.

Chairman **St Germain**. That's all I wanted. Thank you.

You may proceed.

Mr. **Passarelli**. The subcommittee has asked our views on giving the regulators authority to impose civil money penalties on financial institutions for failure to report under the Bank Secreacy Act. It also asked to what extent supervisory powers might be extended to uncover criminal activity such as tax evasion, drug trafficking, or money laundering.

As I explained in my full written statement, it is our view that where other authorities—Treasury, Justice, or IRS—already have primary responsibility for imposing penalties under the Bank Secrecy Act, it does not appear necessary or desirable to duplicate this authority. However, if violation of the Bank Secrecy Act were added to the grounds for removal of institution officials and employees, we believe that a significant deterrent effect would result.

The subcommittee also asked our view on the right to Financial Privacy Act. The act permits our agency to transfer information from the accounts of protected customers to the Justice Department or other appropriate Federal law enforcement authority without prior notice to or approval from the customer.

Notice to the customer is required, however, within 10 days after the transfer. This has two adverse effects. First, a customer who is involved in a suspected crime may destroy evidence or disappear in response to the notice. And second, an innocent customer, such as a person who does not know that his savings account had been manipulated, may be shocked by the notice.

The administrations bill, H.R. 2785, would amend the right to financial privacy act to allow the flow of information required to combat crime without having to notify customers.

Moreover, this bill contains the provisions which we believe are necessary to make money laundering a crime if done with intent, knowingly or with reckless disregard for the origin of the unlawful funds.

We support this bill.

We'd also like to make several recommendations for amendments to the Change in Savings and Loan Control Act.

Specifically, we encourage the subcommittee to consider:

First, extending from 60 to 90 days the period for objection to an acquisition in order to give the Board sufficient time to review and process control act notices.

Second, clarifying the Board's authority to define by regulation the term "control," with respect to the power to direct the management or policies of insured institutions.

And third, clarifying the Board's authority to define further by regulation the terms "competency," "experience," and "integrity."

The Board also suggests the elimination of a disparity between the Holding Company Act and the Control Act. The Holding Company Act provides for a criminal penalty for willful violations. It also provides for civil money penalties for violation, whether or not they are.

In contrast, the Control Act only provides for civil money penalties and then only for willful violations. In order to enhance the Board's enforcement of the Control Act and the Board's regulations, we recommend that the subcommittee consider amendments to the Control Act to clarify the Board's authority to define by regulation the term "willful."

The Board also recommends amendments to the Control Act that would clarify that a private right of action exists under that act; Clarify that the Board may seek equitable relief for both statutory and regulatory violations; and describe procedures for the Board to follow in assessing civil money penalties.

Thank you for the opportunity to testify before you. My colleagues and I will be pleased to respond to any questions you may have.

Thank you.

[The prepared statement of Mr. Passarelli on behalf of the Federal Home Loan Bank Board and a report with exhibits dated April 17, 1986 can be found in the appendix.]

Chairman **St Germain**. Mr. Passarelli, yesterday we had a very forthcoming witness who had been a money launderer, a smurf. He cooperated with the Government. As a result of his cooperation, many convictions were obtained.

He was telling us—is AmeriFirst not a savings and loan?

Mr. **Passarelli**. It's a savings and loan, yes, sir.

Chairman **St Germain**. Now, are you aware of the testimony yesterday, he thought AmeriFirst was a great institution for smurfers because you can buy a money order for up to $9,000 or $10,000 at that particular institution, among others.

Did you hear about that?

Mr. **Passarelli**. No; I didn't, sir.

Chairman **St Germain**. Do you know, have examinations been conducted at AmeriFirst to determine their compliance with the Bank Secrecy Act and the CTR reporting?

Mr. **Passarelli**. I would assume that——

Chairman **St Germain**. Well, can you give me better than an assumption?

Mr. **Passarelli**. Yes, sir.

Chairman **St Germain**. What?

Mr. **Passarelli**. Well, what I can do, I can get you the date of the last examination. I think I can give you that for the record, sir.

Chairman **St Germain**. Let me ask you this. Can you give us a rough idea of the average denomination of money orders in S&Ls?

Mr. **Passarelli**. I really couldn't say. I really wouldn't know what they would be?

Chairman **St Germain**. They're usually not too high; are they?

Mr. **Passarelli**. That's correct, no.

Chairman **St Germain**. What would you say, ordinarily, a ballpark number.

Mr. **Passarelli**. I——

Chairman **St Germain**. Anybody? You have a few staffers here with you. Does anybody have an opinion?

Mr. **Passarelli**. I really couldn't say.

Voice. Mr. Chairman, we don't have that information readily at hand. We'd be glad to provide it for the record.

Chairman **St Germain**. I would like to know what the average is for institutions in various sections of the country and whether or not there has been an increase in this average over the past 5 years.

Thank you.

Now we'll hear from Mr. James Dudine——

Mr. **Dudine**. Doo-di-nay.

Chairman **St Germain**. Dudine. All right. Chief, Special Activities Section, Federal Deposit Insurance Corporation.

We'll place your entire statement in the record and you may proceed.

STATEMENT OF JAMES R. DUDINE, CHIEF, SPECIAL ACTIVITIES SECTION FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Mr. **Dudine**. Mr. Chairman, I am pleased to be here this morning on behalf of the Federal Deposit Insurance Corporation to report on the FDIC's enforcement of the Bank Secrecy Act and to discuss the steps we have taken and our thoughts on what still could be done to address the problems the criminal element poses to this country's financial institutions.

We have provided the committee with a comprehensive report on our efforts to improve compliance with the Bank Secrecy Act. That report reveals we are finding more violations in the banks we examine. The trend in violations is up partly because of our strategy to focus examination resources on problem banks and banks targeted specifically for having potential Bank Secrecy Act problems. Such banks would be expected to exhibit a higher incidence of violations than a cross-section of the banking population.

The great majority of the violations that we are finding are caused by inadvertent failures to follow bank procedures and represent incomplete or late CTR filings rather than actual failures to file CTR's.

Nevertheless, we're not satisfied with the level of compliance by the banks we supervise and we are continuing to improve our enforcement efforts.

Since this committee held hearings last April, the following steps have been taken.

First, the interagency examination procedures have been revised and are now awaiting Treasury's approval. They have been improved in the areas of international transactions and wire transfers and now cover peripheral bank services such as trust departments and securities dealer departments. Examiners will be required to follow a stricter regimen, look closely at exemptions granted to customers, and to document their activities at various points during the examination.

We have completely revised our educational program for examiners who conduct Bank Secrecy Act compliance examinations. The new program supplements our fundamental examiner training series and on-the-job training. It is delivered at regular intervals in Washington, and regional presentations have been added to reach a larger number of examiners. The program includes information on the latest money laundering methods and instruction on recognizing possible money laundering schemes.

We are working more closely with Treasury and IRS to improve the flow of information and to assist each other in carrying out our responsibilities under the Bank Secrecy Act.

The working group concept has proved to be successful in improving our response to bank fraud and insider crimes. We hope to make similar progress with this concept under the Bank Secrecy Act.

We are making more and better use of external targeting of institutions for Bank Secrecy Act reviews. The Customs Service's analysis of currency flows and cash shipments of individual banks and bank-to-peer group relationships provides regulators with an intelligent way to select banks for examination. We strongly support the work being done in this area.

Because the safety and soundness of insured banks is of utmost importance to the FDIC, the resources we can allocate to Bank Secrecy Act compliance are limited. Thus, the method of selecting banks to be examined for Bank Secrecy Act regulations is very critical to our overall enforcement effort.

In addition to targeting banks based on information from the Treasury Department, IRS, and the Customs Service, the idea of examining a random sample of banks each year is being considered.

FDIC usually conducts Bank Secrecy Act examinations in conjunction with its review for consumer compliance. We have recently begun reviewing Bank Secrecy Act regulations at safety and soundness examinations or conducting an independent examination as circumstances warrant. This approach adds flexibility to our program and permits us to respond quickly to potential problems.

As we have stated in the past, bank supervision and examination procedures cannot assure day-to-day compliance with currency reporting requirements. Financial institutions must install internal controls——

Chairman ST GERMAIN. Mr. Dudine, I've got to say I'm happy in one way and unhappy in another. But I'm happy that you no longer tie this exam in with the consumer compliance exam because I don't think you have many of those.

The happy part is that you no longer tie them together, but you do tie them together with the regular exam. The unhappy part is the paucity of consumer compliance examinations.

Mr. DUDINE. Yes, sir. I'm sure you recognize that our resources are very strained these days.

Chairman ST GERMAIN. Yes. The FDIC Chairmen are always calling for expanded powers for financial institutions so they can go into other areas that really are not closely related to banking, and that would make it even more difficult; wouldn't it? Yes. That question has its own answer because if you are over-burdened already, it doesn't make much sense to take on a bigger burden.

That's a rhetorical question. You may proceed.

Mr. DUDINE. Thank you. During the past 15 months, we have given a lot of attention to improving our efforts to deal with the criminal conduct of bank insiders. We are very encouraged by the progress being made by the Bank Fraud Working Group. The group was formed in conjunction with the interagency agreement signed in April 1985 to improve cooperation between bank regulators and law enforcement agencies in responding to the criminal threat to insured financial institutions.

Similar progress in dealing with the criminal aspects of money laundering is possible under the current legal environment. However, the Government's response to the problem would be strengthened by making money laundering a Federal crime.

H.R. 2785 and other bills address this fundamental weakness and would permit prosecutors to attack organized criminals directly by making money laundering the crime rather than having to build their cases on failures to file currency transaction reports.

We support a Federal crime of money laundering and generally agree with the higher penalties and stiffer sentences contained in H.R. 2785. That bill also contains much needed amendments to the Right to Financial Privacy Act.

There is no question that the Right to Financial Privacy Act serves as a legal and psychological barrier to the flow of information from financial institutions and their regulators to Federal law enforcement agencies. Unimpeded information flows are essential to the successful investigation and prosecution of financial criminals and money launderers. This dysfunctional impact appears to reach well beyond the legitimate privacy concerns that Congress intended to protect.

As we have pointed out before, the act, as interpreted by most interested parties, extends the customer-privacy protections to bank insiders who are often also customers of the bank. Insider abuse of federally insured financial institutions is unquestionably a major cause of bank failures and of losses to the FDIC's insurance fund. We believe that insiders, by virtue of their position in federally insured institutions, ought to be treated differently than a bank's "arms-length" customers.

The amendments to the Right to Financial Privacy Act contained in H.R. 2785 would correct this and other flaws, while preserving the privacy interests of law-abiding bank customers. Moreover, financial institutions would be freed from the restrictions and uncertainties now affecting their ability to make informative criminal referrals.

In conclusion, I am convinced that we are making progress in our efforts to deal with criminal conduct in the banking industry. The commitment by the Department of Justice evidenced in the signing of the interagency agreement and the efforts to date of the Bank Fraud Working Group are important examples of the type of progress that can be achieved by working together.

This working group approach should work equally well for the agencies charged with the responsibility to enforce the Bank Secrecy Act.

Thank you.

[The prepared statement of Mr. Dudine on behalf of the Federal Deposit Insurance Corporation [FDIC] can be found in the appendix.]

Chairman **St Germain**. Thank you, Mr. Dudine. Now we will hear from, not a stranger to our subcommittee, Robert B. Serino, who is Deputy Chief Counsel for Operations, with the Office of the Comptroller of the Currency.

We will put your entire statement in the record. You may proceed.

STATEMENT OF ROBERT B. SERINO, DEPUTY CHIEF COUNSEL (OPERATIONS), COMPTROLLER OF THE CURRENCY

Mr. **Serino**. Thank you, Mr. Chairman.

Thank you for the opportunity to bring you up-to-date on the activities of the Office of the Comptroller of the Currency in the Bank Secrecy Act area, and to express our view on the legislative changes needed to facilitate our efforts and to assist the law enforcement community in its criminal enforcement efforts.

As supervisors of the national banking system, we share this subcommittee's concern that our Nation's financial institutions not be used wittingly or unwittingly to facilitate or conceal criminal activity. We recognize the importance of our role in assisting the law enforcement community and have worked to support their efforts.

While we believe we have made substantial progress in the past year, we recognize that much more needs to be done. The progress report which we provided to you earlier this week in the attachment to this testimony addressed questions you asked in your March 27, 1986 letter. I will not repeat what we have written, but would like to highlight for you certain points.

First, we have improved our management control over the agency's Bank Secrecy Act program. We have, for instance, established in the Chief National Bank Examiner's office a central clearinghouse for BSA operations. Our Enforcement and Compliance Division in the law department has been coordinating activities and giving legal guidance. In each of our districts, we have established focal points for bank secrecy activities. Bank secrecy specialists are in each of the districts, as well as our district counsel and our district attorneys, who are charged with additional responsibilities. These changes have ensured a continuing focus on BSA issues, a reliable flow of information on BSA matters, and a sound operating structure for BSA compliance activities.

Second, we have intensified significantly our BSA training of our examiners. During the past year alone, over half of our examiners received training in BSA matters. This training was put together by our BSA specialists and attorneys and was presented at various district staff conferences. It was also presented in our white collar crime school that we give four times a year for our examiners, and was given to our associate national bank examiner school for advanced studies.

Likewise, in the training area, we give significant amounts of on-the-job training. Through this method, BSA training has been given to many of our examiners.

Third, not only have we sought to train our examiners, but we have also taken great steps to increase the awareness with the industry. Attached to the material we submitted earlier, Mr. Chairman, were several bulletins that we have forwarded to the banking industry. We do that as a matter of course and we think it's very helpful.

We likewise have provided speakers to participate in meetings before banking and law enforcement community groups to discuss Bank Secrecy Act and other enforcement issues. We continue to provide materials to the industry on bank secrecy matters.

Fourth, we are a very active participant in various inter-agency task forces and working groups and have continued to assist the enforcement community whenever possible. We were, for instance, in late 1984, instrumental in establishing a working group consisting of senior officials from our office, the Department of Justice Criminal Division, the FBI, and each of the major financial institution regulatory agencies. The group's purpose was to improve the Federal Government's effectiveness in fighting crime in the financial institutions.

In my opinion, the group made significant progress during 1985 and continues to operate effectively. Chief among its achievements were a variety of improvements in communications between and among the financial institution regulatory agencies and the law enforcement community.

A standard criminal referral form was designed and implemented by each of the supervisory agencies and is being used by each of the supervisory agencies and by the financial institutions.

Agreement was also reached that each regulatory agency would issue or adopt regulations or guidelines similar to those that we already had outstanding which require banks to report any suspected criminal violation.

In addition, the group improved communications and established a network of individuals responsible for coordinating referrals and prosecutions.

Likewise, to accelerate the OCC's response to law enforcement inquiries, we have recently formally delegated additional authority to our district offices to respond and provide information directly to the law enforcement community.

We have also enhanced our enforcement and compliance information system to track criminal referrals and improve communications.

The working group also recommended and worked to develop a joint training course to cross-train FBI agents and bank examiners. A series of joint training sessions have been held, both at the FBI Academy at Quantico and at selected sites around the country. These training courses are an ongoing undertaking.

In addition to our work with the Department of Justice working group, OCC participated actively in efforts specifically focused on improving BSA enforcement. We worked with the Treasury Department and other financial institution regulatory agencies to revise the uniform BSA examination procedures.

We also vigorously support the work of the IRS financial institutions regulatory working group which was created in December 1985 after the IRS was delegated additional responsibilities under the Bank Secrecy Act. This group will play an important role in facilitating communications among the agencies and in providing a vehicle for resolving many of our problems.

Despite this progress, Mr. Chairman, we believe that we must continue to do more. To ensure that the progress of the last year is not lost, on-going training and industry awareness are critical. However, in light of the Deficit Reducation Act of 1985, although OCC remains committed to such efforts, we may not be able to maintain the same pace we did during 1985.

Resources have been severely strained and it has been necessary to make across-the-board reductions in training expenditures. Moreover, district training conferences and OCC attendance at public conferences and seminars, which have been valuable vehicles for sharing information on BSA matters and other important topics, have been cancelled or reduced.

In addition to ongoing training and education efforts, we believe that progress is essential in two critical areas if gains are to be made in the Federal Government's efforts to ensure compliance with the Bank Secrecy Act. These areas are, first, the increased coordination among agencies with BSA responsibility and, two, continued use of available data for targeting our limited resources.

Mr. Chairman, we have great faith in the benefits which can be derived from an interagency working group. The Justice Department working group has proven how effectively the bank regulators can work together with the law enforcement community. In my opinion, that working group accomplished tremendous things working together. The desire for all to work together going forward gives me great hope for the future in the criminal law area.

As an active participant in the IRS financial institution regulatory working group, we are looking forward to the same successes in the BSA area.

Improved communications and utilization of available BSA material and other financial data could, we believe, significantly increase the return on our resources. Clearly, neither the OCC, nor any other agency, has the resources necessary to find all compliance violations through the examination process. Instead, our examiners continually make judgments based on available information as to where problems are most likely to exist, targeting their effort in an attempt to identify and correct the most serious deficiencies.

We have had some successes in targeting BSA compliance efforts using computer analyses provided to us periodically by the Customs Service. We actively encourage further efforts through the IRS working group to increase the use of available data so that we can target institutions for intensive compliance reviews.

A great deal can and has been accomplished. We believe, nevertheless, that additional legislation is necessary to eliminate restraints on interagency cooperation and coordination, and to specifically address those who launder money.

We agree with the general concept and intent of the various money laundering bills that have been proposed. We support the administration's proposal. Among other things, these bills would specifically make it a substantive crime for anyone to knowingly use or allow a financial institution to be used to engage in financial transactions with criminally derived property.

We fully support the concept of such proposals. We believe, however, that care must be taken to ensure that the law does not proscribe inadvertent conduct or unwitting participants.

We likewise believe that the proposed modifications to the Right to Financial Privacy Act are necessary to enable individuals and institutions to make referrals of suspicious activities to the law enforcement community without inadvertently exposing themselves to potential liability for violations of the RFPA or other privacy acts, whether State or Federal.

The bill introduced by Representative Hughes, H.R. 1474, would make wire and other electronic transfers subject to being reported on a currency or monetary instrument report.

In light of the number of wire transfers that occur between institutions daily, we doubt this provision would be cost effective. Also, in light of the Treasury Department's new regulation, which enables them to require a specific financial institution to provide copies of all wire transfers for a particular period, we do not believe such a provision is necessary.

We believe changes are also needed in other laws which constitute constraints in our efforts to work with the law enforcement community. These barriers, which include the RFPA, certain State privacy acts, grand jury secrecy rules, and the procedures of various agencies, limit cooperation among the Federal supervisory and law enforcement officials.

While these statutes are designed to protect values we all support, they unduly restrain legitimate Government information-gathering and the free flow of information between and among the agencies.

We have found that the RFPA, in particular, has interfered with our criminal referrals and has in all likelihood degraded the ability of the recipient agency to decide which of those referrals should be pursued.

Similarly, the grand jury secrecy rule limits and prevents the law enforcement community from working closely with our office and sharing information that they obtained before Federal grand juries.

These limitations on the ability of the Federal agencies to cooperate were highlighted significantly in the agreement reached and signed by all the agencies on April 2, with a unanimous recommendation that legislative relief be swiftly obtained.

Law enforcement agencies and bank regulatory agencies alone can only provide a part of the solution. The industry's own commitment and efforts at self-policing are essential because the banks' own internal control processes are in fact the most effective mechanism for ensuring compliance.

We believe the industry has done much since January 1985 to address the Bank Secrecy Act problems. We encourage a continued effort on behalf of the industry.

With the changes we have urged and with an active interagency working group and a committed industry, we are confident that the substantial additional progress and efforts to prevent the Nation's financial institutions from wittingly or unwittingly being used to further criminal activities will be possible.

We fully support this effort.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Serino on behalf of the Office of the Comptroller of the Currency [OCC] can be found in the appendix.]

Chairman St Germain. Mr. Serino, you do agree that the wire transfer problem is also an important and significant one, I'm sure, because we had testimony yesterday from the IRS on the Botero case down in Florida and on the Mankiewicz case, where they actually had a bank president, as well as some officers, involved in California.

In those two examples he gave us, he said they were the classics because they used the wire transfers to transfer the money to either Swiss banks or banks in the Grand Cayman of the Bahamas.

So we do have to be alert to the wire transfer problem, although I can appreciate the fact that it could be very burdensome.

Let me ask this question of you gentlemen, and then we will go to Mr. Keating.

Mr. Serino. Do you want me to comment on the wire transfer issue?

Chairman St Germain. OK.

Mr. Serino. The problem is burdensomeness. I think that the Treasury Department's regulations—which will allow them to go to a particular institution and tell the institution, for the next 2 weeks, to provide copies of all the wire transfers coming in—is an effective way of targeting particular institutions that we think might be involved in using wire transfers.

Chairman **St Germain**. I heard you say that one of your task forces agreed that it needs some legislative assistance in a timely fashion.

In other words, you don't want this to drag on and on and on. I certainly am sympathetic to that.

In fact, the way I'm looking at it right now, I think I'm going to gather some of my committee members together and say to them, let's look at what is universally acceptable and agreeable and let's enact that now and where we have some of the sticky wickets, we'll leave those to work on later.

But I don't think that we should sit back and wait until we've dotted every "i" and crossed every "t." If we run out of dots and crosses, well, let's put those aside. But let's enact that which is universally agreed upon.

Does anybody on the panel, including Mr. Keating, disagree with that?

Mr. **Serino**. Mr. Chairman, I fully support that. In fact, I would suggest that a real focus be made on how can the law enforcement agencies coordinate and communicate better with the banking agencies and vice versa.

Chairman **St Germain**. Mr. Serino, you had better be careful because, I remember Penn Square, OK, where the Comptroller's Office was not communicating with the Comptroller's Office.

Do you recall that?

Mr. **Serino**. We have made some significant improvements, Mr. Chairman——

Chairman **St Germain**. You've been making significant improvements. You did it after—what was that little bank in the Texas shopping center years ago? The Sharpstown.

Mr. **Serino**. Sharpstown was a State bank, Mr. Chairman.

Chairman **St Germain**. OK. Well, then, let's go to Franklin National. Let's go to our friend in California, USNB, in San Diego.

Mr. **Serino**. Mr. Chairman, the point——

Chairman **St Germain**. The significant, sweeping changes, Jim Smith's computerization and all of that—don't get me wrong. You have to keep trying. You have to keep trying, and that's the only way you get better, by constantly working at improvement.

Mr. **Serino**. The point I would like to make is that we think that one of the problems is the ability, for us to communicate with law enforcement and them to communicate with us. And we think two minor changes will solve that problem. One is in the right to financial privacy, and that is in your bill, and the other is in the grand jury secrecy rule that prevents law enforcement from giving us information from grand juries.

We think those two pieces will help.

Chairman **St Germain**. Well, remember, we have a jurisdictional thing here. There are those areas where we have jurisdiction, fine. That's where we'll proceed. And I'm of a mind not to wait for other committees and their jurisdictions.

That's what I meant a little earlier.

And now we will hear from Francis Keating, who is the Assistant Secretary of the Treasury for Enforcement and Operations.

We will put your entire statement in the record. You may proceed.

STATEMENT OF FRANCIS A. KEATING II, ASSISTANT SECRETARY (ENFORCEMENT AND OPERATIONS) TREASURY

Mr. KEATING. Thank you.

Mr. Chairman, I sincerely appreciate the opportunity to appear before you to discuss legislative responses to the problem of money laundering, especially legislative initiatives that will enhance Treasury's enforcement of the Bank Secrecy Act.

This is my first opportunity to testify before Congress on this subject since I assumed the position of assistant secretary for enforcement some 90 days ago, and to affirm to you my commitment to rigorous enforcement of the Bank Secrecy Act, as I personally assured you in my office meeting with you.

I'm pleased to introduce Mr. Robert Stankey, the Acting Director of the Office of Financial Enforcement, who I know is a familiar figure to you, Mr. Chairman, and to the members of your staff.

Mr. Stankey has been with Treasury since the inception of the Bank Secrecy Act. It is fair to say that he, more than any other person, has been responsible for the development of the Bank Secrecy Act into an effective law enforcement weapon and the cornerstone in Treasury's Financial Law Enforcement Program.

Before turning to the legislative measures, I would like to briefly update you, Mr. Chairman, on Treasury's Bank Secrecy Act enforcement activities since my predecessor testified before you last year in your hearings following the *Bank of Boston* case.

On February 14, 1986, we prepared for the committee a report on those activities which we have made available for distribution today.

First, I would like to discuss Treasury's imposition of civil penalties against financial institutions for past noncompliance. In the wake of the publicity surrounding the *Bank of Boston* case, and in good measure as a response to the hearing of this committee, over 60 banks or bank holding companies have come forward to Treasury with past violations of the Bank Secrecy Act. To date, 15 civil penalties have been assessed ranging from $112,000 to $4.75 million in the case of the Bank of America. Other cases are under review and we anticipate assessing additional penalties shortly.

We believe that Treasury's rigorous enforcement of the Bank Secrecy Act, including the imposition of publicly announced substantal civil penalties, where appropriate, has contributed to enhanced Bank Secrecy Act compliance.

Another major initiative has been our work with bank supervisory agencies to improve and standardize Bank Secrecy Act examination procedures. Our experience in this effort has made clear to me the need for an ongoing interchange of ideas between us at Treasury and the agencies to which Treasury has delegated Bank Secrecy Act enforcement responsibilities.

Therefore, I am convening a permanent interagency working group on Bank Secrecy Act compliance consisting of representatives of Treasury, Customs, the Internal Revenue Service, SEC, and the bank supervisory agencies. The group will be chaired by the

Deputy Assistant Secretary in my office for law enforcement, David Queen, and will meet monthly or more frequently as needed. We will use this forum to discuss not only examinations——

Chairman ST GERMAIN. Mr. Keating, when you say the bank supervisory agencies, do you include the NCUA?

Mr. KEATING. Pardon me?

Chairman ST GERMAIN. Do you include NCUA?

Mr. KEATING. Mr. Chairman, at this time, the specific membership of the committee has not been set. But any that would be relevant——

Chairman ST GERMAIN. You mean this subcommittee is receiving the initial announcement of this?

Mr. KEATING. Yes. We're taking this opportunity to announce our plan, Mr. Chairman, but we certainly intend to have the first meeting very soon and the membership of the committee.

Chairman ST GERMAIN. Well, I would recommend that NCUA be included because from testimony to date, we know that they do have checks and money orders and what have you at credit unions as well. So credit unions could be utilized by smurfs.

Mr. KEATING. Very well. I appreciate the suggestion, Mr. Chairman. We'll do that.

We will use this forum to discuss not only examination procedures, but mutual enforcement problems and Treasury policy initiatives, including revisions to regulations.

In July 1985, the Treasury Department established the Office of Financial Enforcement. This provided a focal point for the Bank Secrecy Act-related activity within the Treasury Department and acknowledged the increasing importance of the act in Treasury's law enforcement efforts.

The Office oversees the compliance activities of all agencies that have been delegated responsibities under the act and we have increased its staff resources for this purpose.

In addition, there has been a very large commitment of resources both by Customs and the Internal Revenue Service.

Since last year, we have strengthened the Treasury Bank Secrecy Act regulations in several important respects. On May 7, 1985, casinos were designated as financial institutions subject to Bank Secrecy Act reporting and recordkeeping requirements.

Last summer, a regulatory amendment pertaining to international transactions was published as a final rule. Under the regulations, Treasury will be able to require a financial institution or a selected group of financial institutions to report specified international transactions, including wire transfers or cashier's checks for a defined period of time.

We are also discussing a number of other regulatory amendments, including regulatory solutions to the problems of smurfing and structuring transactions to avoid the reporting requirements.

As with all amendments to the bank secrecy regulations, Treasury will consider carefully the financial and operational impact of regulatory changes on financial institutions as it seeks to meet the legitimate needs of law enforcement.

I would now like to discuss, with your indulgence, Mr. Chairman, the various proposals under discussion to bolster our attack against money laundering and to improve Treasury's enforcement of the Bank Secrecy Act.

First is H.R. 2785 and 2786, the Money Laundering and Related Crimes Act, which was developed jointly by the Departments of Justice and Treasury.

I would like to comment on the critical revisions to the Bank Secrecy Act contained in the bill. Most important, the Secretary would be given summons authority both for financial institution witnesses and documents in connection with Bank Secrecy Act violations. This authority is essential to enforcement of the act, especially with respect to miscellaneous nonbank financial institutions, such as casinos and foreign currency brokers which now number in excess of 3,000.

The responsibility for compliance review of these institutions has been delegated to the Internal Revenue Service. However, the IRS summons authority is restricted, as indicated this morning, to title 26 purposes only. Therefore, in examining these institutions, IRS must rely on voluntary cooperation.

Under this bill, a summons would be issued only by the Secretary or with his approval, by a supervisory level official of an organization to which the Secretary has delegated Bank Secrecy Act enforcement authority. For example, the Internal Revenue Service, the Comptroller of the Currency, or the Customs Service.

H.R. 1367, by contrast, provides that Treasury may not delegate summons authority. For Treasury, the ability to delegate that authority is a practical necessity.

The bill also provides for a civil penalty for negligent violations of the act. Currently, Treasury has authority to assess civil penalties only for willful violations, with willful in the civil context meaning with specific intent or with reckless disregard of the law.

The prospect of penalties for negligent violations will encourage financial institutions to give more attention to good compliance.

The bill also provides important revisions to the Right to Financial Privacy Act. The most important and least controversial of those revisions is the amendment to subsection 1103(c) of the act. Currently, that section provides that nothing in the act shall preclude financial institutions from notifying a Government authority that the institution has information "which may be relevant to a possible violation of any statute or regulation."

The statute gives no guidance on what information can be given without running the risk of exposure to civil liability under the RFPA.

The proposed amendment sets out explicitly that enough information can be given to enable Federal law enforcement authorities to proceed with legal process. We believe you should find very little opposition in the financial community to this particular revision of the RFPA. The revision imposed is no new legal duty on financial institutions and clarifies the right of financial institutions to act as good citizens without the risk of civil liability.

For consistent application throughout the United States, this amendment must be accompanied by the proposed preemption provision so that a financial institution that complies with the act will not run afoul of any more restrictive State privacy laws.

The proposed clarification of the good faith defense to civil liability is also needed to protect financial institutions who cooperate with Federal law enforcement in good faith within the confines of the Right to Financial Privacy Act.

In addition to the administration's money-laundering bill, Mr. Chairman, there is another legislative initiative on which I urge early and favorable action. That is the bill introduced yesterday by Congressman Pickle and Senator D'Amato. This bill would prohibit structuring of currency transactions to avoid the $10,000 currency transaction reporting requirement, including the well known practice of smurfing. The proposal would make a person who structures transactions to avoid the currency reporting requirements or who causes a financial institution not to file a required report, subject to the criminal and civil sanctions of the Bank Secrecy Act.

The bill also provides necessary seizure and forfeiture authority for currency related to a domestic CTR reporting violation.

With respect to the other bills before the committee, Treasury respectfully opposes two provisions in H.R. 1474. Section 3 of H.R. 1474 would provide that every Bank Secrecy Act reporting exemption be approved first by the Secretary. Under the current regulations, a bank may exempt from reporting certain cash deposits and withdrawals of accounts of retail businesses in amounts commensurate with the lawful customary conduct of such business.

It would be unwise, in our view, to shift the burden of monitoring the eligibility of bank customers for exemptions away from the bank which knows its customers best.

Section 4 of H.R. 1474 would require that every person——

Chairman ST GERMAIN. Excuse me, Mr. Keating.

Mr. KEATING. Yes, Mr. Chairman.

Chairman ST GERMAIN. I can see where you have a problem with the Secretary's having to approve this. But you just said the bank knows the customers best.

Now, in South Boston, the Bank of Boston's employees obviously never read any Boston newspapers, where the Anjulo family was portrayed over many, many years on the front pages of the newspapers. And these are the very people, the Anjulos, who were coming in with sacks full of money, and they had an exemption. And the branch manager was born and brought up in South Boston, probably went to the same church, was confirmed and received Holy Communion for the first time from the same priest as the Anjulo family, did you know that?

So to say the bank knows best is not a totally accurate statement because sometimes they know best, but they don't always know best.

Mr. KEATING. Mr. Chairman, we don't question for a minute the fact that there are situations that have occurred in the past and would occur in the future where bank officers or directors or employees would be participants in the violation of the act. But we would hope that the criminal and civil penalties that would be applicable to them would be adequate. Certainly if we were able to have the money laundering——

Chairman ST GERMAIN. To the employees.

Mr. KEATING. That's correct. Especially if we had the money laundering act passed, would take care of that situation.

Chairman **St Germain.** OK.

Mr. **Keating.** What we're especially interested in, Mr. Chairman, of course, is to provide the bank the discretion, where that discretion is appropriate, to handle the exemptions as they have in the past, and as the chairman knows, in most cases, have handled it with credibility and integrity.

Section 4, Mr. Chairman, of H.R. 1474, would require that every person, including every financial institution, report all outgoing international wire transfers. Treasury already has authority under the act to require reporting of international wire transfers. Wholesale reporting of international wire transfers would not be in keeping with the restriction of section 5314 that Treasury consider the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency. And that's explicitly in the statute, Mr. Chairman.

This broad reporting requirement would burden financial institutions out of all proportion to the utility of the information generated.

I would now like to turn to H.R. 4280. This bill would make two major changes to the Bank Secrecy Act. First, it would amend 31 U.S.C. 5313 to provide that the Treasury could only require reporting of domestic currency transactions in excess of $10,000. We strongly disagree with this restriction on our rulemaking flexibility because it would adversely affect our ability to respond to changing law enforcement needs.

Another provision of H.R. 4280 would require a financial institution to keep special records relating to any cash transaction in excess of $3,000. Similar proposals have been under discussion within Treasury and within the Department of Justice as regulatory solutions to the various schemes being used to avoid the currency reporting requirements.

We believe that a regulatory, rather than a legislative, response is appropriate to address these situations so that we can maintain the flexibility to respond to changing law enforcement needs.

Moreover, in considering any proposal that imposes a new requirement on financial institutions, the cost and administrative burden to the institution must be considered, as well as the law enforcement interest served.

Another bill introduced by Congressman Wortley provides that Treasury review all exemptions not less than once a year, and in any case in which there's a change in management or control of a financial institution.

The annual review of all exemptions is a practical impossiblity. However, we would have no objection to the review of exemptions when there is a change of control or ownership.

Finally, Mr. Chairman, I want to express my appreciation for the continuing interest and support that you and the other members of this committee have demonstrated for Treasury's administration of the Bank Secrecy Act.

This concludes my prepared remarks. Mr. Stankey and I would be pleased to answer any questions that you or any member of the committee might have.

[The prepared statement of Mr. Keating can be found in the appendix.]

Chairman St Germain. Thank you.

Mr. Keating. Yes, sir.

Chairman St Germain. We had testimony yesterday from a gentleman who was a professional money launderer and then came over to the Government to assist the Government. As a result thereof, many prosecutions and pleas were obtained.

But when he described his operations and the manner in which he operated, he laundered $100,000 a day with no problem. On any given day, he was out in California and a stranger—he asked a yellow cab driver at the airport where a lot of banks were. He said: Wilshire Boulevard. So they laundered $200,000 in a matter of hours on Wilshire Boulevard. One of them could hardly talk English and the other one was very fluent in English.

But that doesn't bother me as much. It's bothersome. But the operation in Miami, where this man was going to the same institution on a regular basis and purchasing $9,000 in cashier's checks or money orders, sometimes going to the same teller once a week or twice a week, and never a question was asked bothers me more. Questions were never asked.

Do you provide training films or informative films not only for your examiners, I would ask the regulators, but also to the financial institutions?

Have you made one up for the financial institutions so they could instruct their tellers and their employees and their branch managers not to act like Mickey the Dunce when people come in. Again, it's similar to the situation that prevailed in South Boston, when you see people coming in on a regular basis with large amounts of money, particularly strangers, no questions are asked.

Have you given any thought to that? I mean, the bill that Mr. Torres introduced and I cosponsored, brings the amount down to $3,000. You say that would be burdensome. But let me ask my second question.

Mr. Keating, could you establish regulations that would bring the present $10,000 requirement down to $2,000 for any particular area? For instance, the Miami area obviously is replete with money launderers. By the same token, if you went to Vermont and New Hampshire, you would not find much money laundering there. Could you establish regulations on a regional basis?

Mr. Keating. Mr. Chairman, I might say in partial response and then I'll have to turn to Mr. Stankey for some advice on the latter part of your question, but in partial response, we are at this time reviewing possible regulations that would affect a smaller amount of money involving cashier's checks, for example.

As far as regional regulations, if I may defer to him briefly, I'll find out.

[Pause.]

Mr. Keating. I'm informed that the legalities of it are unknown at this time, but obviously, anything that would affect and improve law enforcement response in this area will be viewed.

Now whether or not it can be done, I don't know. We'll take a look at it.

Chairman St Germain. If you would take a look at that, because I don't know which committee would be involved; but, nonetheless, I think it's worthy of review because there are certain areas where there's a lot of money laundering going on.

Gentlemen, with respect to the fact that some institutions and some bank employees seem to look the other way almost purposely, do any of you have any thoughts on how to solve that problem? My one suggestion now is to lower the amount, but that still doesn't help with the employees who pretend that nothing's amiss when strangers come in to launder money.

Mr. Woodard, what's your reaction to that? Do you have any thoughts?

Mr. **Woodard**. Not so much on the issue of lowering the dollar amounts. But one of the things that we've been trying to put a lot of emphasis on is that once we get our act together in getting compliance with the filing requirements, we've certainly got to be in a position to know how to use that information effectively.

That's the general thrust of the approach that we're taking. I really don't have an answer in terms of dollar amounts.

Chairman **St Germain**. Mr. Serino.

Mr. **Serino**. Mr. Chairman, one of the things that I think is helpful to us is the passage by the Congress of the new bribery statute that makes it a crime now for an employee of the institution to take something of value before perhaps laundering——

Chairman **St Germain**. Mr. Serino, there was no allegation that anything of value was taken. There was no bribery involved—just inattention or pretension of stupidity, almost.

I am referring to the situation that was described to us yesterday. The same man went into the same institution once or twice a week on a weekly basis, with $9,000 in cash. Questions were never asked and he did this for about 8 or 9 months in the very self-same institution, with a group of maybe 10 or 12 banks. He was laundering $100,000 a day, in 10 or 12 banks. No allegation of bribery. That's not the point.

Mr. **Serino**. OK. Well, I guess the answer would be, then, that we have stressed the requirements for banks to, in fact, train their employees. We think they have, in light of the hearings you had back in April, have taken that to heart and they are doing significant training of their employees.

In fact, several of the institutions themselves are going around giving conferences on how to comply with the bank——

Chairman **St Germain**. There is an ABA representative here today. Maybe the ABA representative could get a hold of Mr. Freidberg, who testified yesterday, and have him repeat his description of how this was done in a film and then they could sell that film to their institutions. This would help poor Mr. Freiberg, who has had to sell his house and his condo and hasn't been working because he's been testifying all over the place, helping the Government and not being paid for any of this.

So maybe the ABA could give serious consideration to helping this wonderful citizen and helping solve this problem.

Mr. **Serino**. Well, the ABA itself did put together a conference, as you know, Mr. Chairman.

Chairman **St Germain**. I'm aware of that.

Mr. **Serino**. And many other people have put together conferences.

Chairman St Germain. But, you see, we can't legislate every little bit of this. It's common sense that has to prevail here, I think.

I want to get to the other Members' questions. Let me ask all of you this.

Some of you use nice terminology, but what it boils down to—Mr. Serino, has Gramm-Rudman cut into your available personnel? I think you said that you had to cut out conferences, training seminars, et cetera; right?

Mr. Serino. That's correct, Mr. Chairman.

Chairman St Germain. So Gramm-Rudman is proving to be a problem as far as enforcement of the Bank Secrecy Act is concerned, and enforcement of regulations and detection of drug traffickers, tax avoiders, et cetera.

Mr. Serino. We have felt that our training conferences not only for our examiners, but for the industry, have been very valuable. And we have cut those out now.

We are also under a hiring freeze so that we will not be able to bring on new examiners, so we will be hurting down the road when these examiners should be——

Chairman St Germain. Of course, we have more and more institutions—not to get away from this—that are having problems because of the farm situation, the energy situation and foreign debtors. And there, again, with a reduced work force, you have an increased workload.

Is that not a fact?

Mr. Serino. That's correct, Mr. Chairman.

Chairman St Germain. Mr. Dudine, this is happening at the FDIC as well; correct?

Mr. Dudine. Yes, sir, no question about it.

Chairman St Germain. So Gramm-Rudman has proven to be burdensome, or has proven to make it more difficult for you to discharge your duties?

Mr. Dudine. Yes, sir. We've cut back on our 1986 hiring projections and, as you know, safety and soundness is our top priority, and our resources are directed there first.

Chairman St Germain. What was your percentage cut, to date, as far as the number of personnel are concerned?

Mr. Dudine. We had planned to hire, I believe, something like 600 new examiners. We have cut that to approximately 400 in 1986.

Chairman St Germain. Yes. But were those to replace those that are leaving——

Mr. Dudine. Yes, sir.

Chairman St Germain [continuing]. Or to increase the overall requirement?

Mr. Dudine. A little bit of both. We've had a lot of examiners leaving. We've had a good deal of our examination staff transferring its activities to our liquidation area.

So there's a little bit of both.

Chairman St Germain. So the overall number is remaining the same or is it going down after this first cut?

Mr. Dudine. Based on our 1987 projections, Gramm-Rudman-Hollings will require drastic cuts.

Chairman St Germain. It will be going down drastically. Can you give us any numbers?

Mr. Dudine. I don't really have those numbers. I could give you a ballpark figure.

Chairman St Germain. Well, would you supply them for the record, please?

Mr. Dudine. The impact of Gramm-Rudman-Hollings on FDIC's 1986 operations will primarily affect training and employee relocations. The real impact will come in 1987. Anticipated staff levels at the end of 1987 would be at least 400 fewer than the minimum necessary to carry out our responsibilities in an effective manner. We currently have about 1,650 examiners in the field and project about 1,800 examiners by the end of 1986, the munimum number needed to effectively carry out our mission. Gramm-Rudman-Hollings would necessitate cuts, through postponed hiring and furloughs, of about 400 examiners in 1987.

Chairman St Germain. Mr. Passarelli?

Mr. Passarelli. It won't affect our field staff because they've been transferred to the bank system. But it will——

Chairman St Germain. OMB hasn't been able to get at those yet? [Laughter.]

Mr. Passarelli. But they will affect our headquarters staff. You know, you mentioned about an effective way to maybe get the institutions the proper training and encourage them to comply with the Bank Secrecy Act. In my testimony, I recommended it, perhaps. You might want to amend the act to allow for the removal of an officer or employee if they violate the Bank Secrecy Act.

I think that's an effective way to get their attention.

Chairman St Germain. Mr. Woodard, has Gramm-Rudman had an effect on your work force?

Mr. Woodard. Not at this point, Mr. Chairman. We're not sure what the overall effect is going to be because the Commissioner's position has been to try to protect the enforcement activities.

The budget situation was such that, based on the Grace Commission recommendation, the examination function has been scheduled to receive an additional 2,500 staff-years a year for the next 3 years. And that first increment was included in the President's budget for fiscal year 1987.

How that will roll out when we get through Gramm-Rudman, we really don't know.

Chairman St Germain. Mr. Keating, is Gramm-Rudman going to affect your ability to enforce or oversee the Bank Secrecy Act?

Mr. Keating. Mr. Chairman, it's difficult to say because, of course, we don't know how far or how long Gramm-Rudman will bite.

Recently, prior to my coming here 90 days ago, the resources within the Office of Financial Enforcement were increased. Our office is a small office and to date, we have had no adverse impact.

I might say that it's unfortunate, but we're losing Mr. Stankey, who is retiring. At this time, I am in the process of assembling a list of candidates for that position.

Once that position is filled, which, hopefully, will be very quickly, the whole resource issue will be reviewed with that individual, as well as with the Secretary.

But to date, we have not had any adverse consequences.

Chairman **St Germain**. I'd like to make this statement and then go to my colleagues. You just mentioned Mr. Stankey and I think it's timely that we thank him for the years he's put in, particularly his 14 years in this division.

We all know that as a result of his efforts and his ingenuity, a great deal has happened in this area. He's been very helpful. As a matter of fact, more than very helpful. He's been, I think, probably the catalyst here to really get this thing off the dime because, as we found out in that first hearing, there were a lot of people ignoring the provisions of the act.

Mr. Stankey, we really and truly are grateful to you, and I think a lot of people in the country should be grateful to you. We want to wish you well upon your retirement. We hate to see you leave.

Mr. **Stankey**. Thank you very much, Mr. Chairman. It's truly been my pleasure to have served the government.

Chairman **St Germain**. Mr. Wylie.

Mr. **Wylie**. Thank you, Mr. Chairman. And I would associate myself with the observation of our chairman with reference to Mr. Stankey's service and say that I, too, think that he'll be missed and hard to replace.

Mr. **McKinney**. Would the gentleman yield for just a moment?

Mr. **Wylie**. Yes, of course.

Mr. **McKinney**. Maybe I'll add my comments to that at this point so it's all in one place. Mr. Stankey has been a ray of sunshine in an otherwise muddled picture. For a great many years that I've been in this town, he has foreborne—and that's a tough word in this town. He's accomplished great things, particularly with some of our friends in Boston and other places.

Mr. **Wylie**. Well, he's been an excellent witness, too, when he's appeared before our committee and has provided helpful expertise, and we'll miss that.

I wanted to follow up just a moment and then go to something else on this idea of across-the-board reductions in training expenses and so forth, vis-a-vis Gramm-Rudman. That's very distressing to me because I had written a letter earlier to the Director of the Office of Management and Budget expressing the thought that I didn't think Gramm-Rudman should be applied to, as you know, the Office of the Comptroller, the FDIC, and the Federal Home Loan Bank Board, because your money comes from fees and assessments on your institutions and is not really taxpayers' money.

I thought that Gramm-Rudman applied to receipts from taxpayers. But it is still being applied to you, as I understand it, Mr. Serino.

Is that correct?

Mr. **Serino**. That is correct, Mr. Wylie.

Mr. **Wylie**. I brought this up with the President of the United States and he had suggested that Mr. Regan look into it. So we might have to revisit that scene.

But, as I say, I'm distressed by what I learned this morning, that some of the examiners that we're going to need to help us in this problem that we have before us are apparently being laid off.

I hope that the panel either heard or heard about the testimony that we received yesterday. The committee learned a great deal, may I say, about the business of money laundering from an honest-to-goodness money launderer.

I would like to commend this panel today, in preparing a response to Chairman St Germain's letter requesting an update on the regulatory agency's examination and enforcement efforts with respect to the Currency and Foreign Transactions Reporting Act.

I think the information, while quite voluminous and hard to digest, is very helpful and indicates, I hope, a word to the chairman, the regulators' intent to continue active enforcement of the Bank Secrecy Act.

But yesterday, Mr. Dudine, we heard from a former Smurf, and on page 7, you note that you are considering a regulatory solution to the problem of smurfing and structuring transactions to avoid the acts reporting requirements. And Mr. Keating referred to this, and the chairman a little earlier. And I did hear his exchange with you, the exchange with Mr. Keating, about reducing the $10,000 reporting requirement.

I'd like you to be a little bit more specific, since you specifically mentioned this in your testimony.

Mr. Dudine.

Mr. **Dudine**. Are you speaking to me, Mr. Wylie?

Mr. **Wylie**. Yes, sir.

Mr. **Dudine**. I don't believe that the FDIC actually proposed any suggestions to that problem. But I could comment on it, if you like. We had issued a communication——

Mr. **Wylie**. I'm taking the statement from your testimony, page 7, that you are considering a regulatory solution to the problem of smurfing and structuring transactions to avoid the act's reporting requirements.

Mr. **Dudine**. Yes, sir. I believe that's Mr. Keating's statement.

Mr. **Wylie**. Oh, that's not in your statement?

Mr. **Dudine**. No, sir.

Mr. **Wylie**. Mr. Keating, would you like to be more specific on that, then?

Mr. **Keating**. Mr. Wylie, at this time, as I indicated, we are in the process of finalizing the preparation and discussion for public comment of a proposed regulation which would apply the bank secrecy penalty to smurfing or the structuring of transactions, as well as to apply the reporting requirement to monetary instrument transactions in excess of $3,000 and require that the purchaser of that cashier's check show identification.

Those will be put out for public comment in the very near future, those proposed regulations. They are the result of the discussions with the Department of Justice.

Mr. **Wylie**. I attributed that statement to you, Mr. Dudine. But my second question is a kind of a followup one and it is with reference to your statement, on page 1, that the great majority of the Bank Secrecy Act violations represent inadvertent failures to follow bank procedures in incomplete or flawed CTR filings rather than actual failures to file CTR's.

Could you be more specific on that? Do you have anything in the way of a breakdown which would indicate where you're coming from there?

Mr. **Dudine**. We have—in the first exhibit, I believe, to the report that we supplied to the committee, we broke down violations by examinations all the way down to the State level by the categories that we used to collect the violations in Washington.

The categories that we used are unfortunately not specific enough to separate out actual failures to file from filings that are either late or incomplete, for whatever reason.

We have made that correction to our system, but the data aren't available at this point. However, we have talked to the people in our regional offices and to some of the examiners who actually go out and do the examinations and it's their feeling that the majority of those violations are not actual failures to file, but, rather, incomplete filings, where some of the information is either inaccurate or not actually placed on the form when they're filed, or the forms are filed late.

We believe that most of those violations really are inadvertent, not wilful failures to file CTR's.

Mr. **Wylie**. You also state on page 4, that even under the best conditions, employees can be corrupted into circumventing the controls and violating the BSA.

Do you have specific information on the percentage of BSA violations that are the result of dishonest employee conduct?

The reason I'm asking is, that gives a different dimension to our problem when we try to pass a law to help you in this regard.

Mr. **Dudine**. I can answer that by saying that when our examiners discover or detect a situation like that, we make a criminal referral, either to the U.S. attorney or to the Treasury, or both, in some cases.

In our experience, those cases would be a very, very small proportion of total violations. Of course, they're very difficult to detect and those kinds of things are not very easily detected by our examination procedures.

Mr. **Wylie**. Mr. Serino, on page 12, you mention that certain State privacy acts unduly restrain legitimate Government information-gathering.

Could you give us examples of those State laws and give us an indication as to what we should do there? Should we pass legislation to override those State laws?

Mr. **Serino**. Well, one area is the State's own grand jury secrecy rules, which I don't think you can do very much about. The one area you can do something about, I think, is in one of the pieces of legislation that talks about pre-empting State privacy laws that interfere with the ability of the institutions to make referrals of suspicious transactions. We would suggest that that may be very helpful, if you could pass something that would pre-empt the State laws in that area.

Mr. **Wylie**. OK. Do you think that the Treasury Secretary should be given summons authority in this field?

Mr. **Serino**. Yes; we do.

Mr. **Wylie**. You do. OK. Thank you.

Thank you, Mr. Chairman.

Chairman **St Germain**. The subcommittee will be in recess so we can cast a vote. We'll be back momentarily and we will continue with the questioning of the panel.

[Recess.]

Chairman St Germain. The subcommittee will come to order.

Mr. McKinney.

Mr. McKinney. Well, one hardly knows where to start because the subject of our sometimes dull, often pedantic, business is really the subject of life and death because without these laundering operations going on, without those cashier's checks and everything else, there is no drug business.

It horrifies this member, Mr. Chairman, to realize that these guys are supervising legitimate businesses where we can sometimes catch the criminals, but nobody's doing a darn thing about the electronic transfers to Panama and other spots around the world.

Mr. Woodard, yesterday one of the IRS people stated that there's somewhere close to $90 billion laundered in this country.

I just canceled two newsletters, closed by Fairfield office, and fired a part-time worker because of Gramm-Rudman. And yet the crooks of this world and the murderers in this country are wondering around with $900 billion.

Mr. Keating, why don't we just pass a law that says there will be no cashier's checks? We don't need them. If you go to a bank where you do business, you can get your check certified and embossed with some kind of a stamp. Then you have a record of what happened. So you can walk in with your $9,000 and it's legal, but somebody is going to look at your bank statement sooner or later and see $9,000, $9,000, $9,000, $9,000. Eventually, someone will say something's wrong here.

It just seems to me that we have to get away from the anomymity of the transfers. The banks can continue to charge the same amount of money for certified checks as they do for cashier checks so they won't lost any of their 35 percent profits.

Do you have any ideas? Would we really be throwing a wrench in? Say you were in Las Vegas and you hit the tables lucky and you got $100,000. You can wire it to your bank but there will be a record.

I just think that cashier's checks have become a method of laundering money and as long as there are as many smurfs around as there seems to be, we have to do something.

I wondered if you had any comment.

Mr. Keating. Congressman, of course, I'm not in any position to discuss commercial needs or banking reality out there.

Mr. McKinney. Oh, go ahead. You've got an opinion. OMB has an opinion on everything in this town. We might as well have some personal ones.

Mr. Keating. We look at it strictly from, at least as to the proposed regulation, that we are considering the $3,000 cashier's check regulation, as a threshold area which will be helpful to identify the money launderer and the smurfer and to permit the IRS to carry out their lawful taxing authority and to permit the U.S. attorneys to prosecute.

And we hope that that regulation, if, in fact, that's the final form it will take, will go a long way toward solving the Bank Secrecy Act violations in that category.

Whether or not we ought to ban cashier's checks all together, of course, is a matter that deserves further inquiry by you and your colleagues.

I'm afraid I'm not that knowledgeable on that subject.

Mr. McKINNEY. Any of you other gentlemen have any comments on this subject?

Mr. SERINO. Just an observation, Mr. McKinney. I think cashier's checks do serve a legitimate commercial need. I think that one way you can address that situation is through the legislation dealing with the smurfing issue, that if somebody is structuring his transactions in cashier's checks under $10,000 to cause the financial institution not to file a form, then maybe we ought to be prosecuting the individual smurf.

Mr. McKINNEY. Yesterday's smurf, so to speak, told us that he and his buddy went out to Los Angeles and they walked through $200,000, wasn't it, Mr. Chairman, or $220,000 worth of money. They hit Wilshire Boulevard, parked their little car and hit each corner bank and nobody asked them for identification, nobody asked them for anything else.

The only complaint they got was that one or two of the deposits took too long to count because they were in 20's instead of 100's.

Now how are you going to handle this? The bank's violating no laws. Nobody's accusing them. The teller is not violating any rules, except, as the chairman stated earlier, one of commonsense. Maybe we should require banks to keep more detailed records of their cashier's checks and require banks to get adequate identification.

I don't know. I'm looking for any solutions at this point.

Mr. KEATING. Mr. McKinney, I might say, that is part of our proposal. Hopefully, it will go a long way toward making sure that incidents like that are isolated and not common.

Mr. McKINNEY. I mean, this outfit that he worked for, this Mr. Bahar, or whatever his name was, was small stuff.

But, anyway, Mr. Bahar had a small operation. There were nine of them blowing $100,000 across—I mean, they were practically having tea parties in the bank waiting for cashier's checks. They all knew each other.

The guy said in his testimony to us that he could look across the room and see other people who were with the same operation. And most of them spoke bad English, which also, I find, is a fascinating point. I feel having sat here, I can continue for a little longer until the chairman raises his gavel.

The fact remains that I can't do anything about this problem unless I get massive support and I don't think I have that kind of massive support yet. But the fact is that I don't think that cashier's checks are necessary. Somehow, we've got to get a better label on who's playing with what. And cashier's checks are a hole in that system if you cleverly use them.

They are not even bothering to be clever, which disturbs me. And as I say, your legitimate businesses that you are patroling electronically are just the minor tip of this iceberg and that's what's so frightening.

I will finish up by saying, Mr. Passarelli and Mr. Dudine, I am working now on a piece of legislation with a legislative counsel which will get OMB, Gramm-Rudman and any other person that has anything to do with the Federal Government out of your life. You are not Federal agencies and they have no right to tell you what to do, review your policies, or determine what your budget's going to be.

That, of course, leaves poor Mr. Keating and the IRS and the rest all suffering with Gramm-Rudman. But when you go to sleep at night, you can figure out we are, too.

Thank you, Mr. Chairman.

Chairman **St Germain**. Ms. Kaptur.

Ms. **Kaptur**. Thank you, Mr. Chairman.

I wanted to ask Mr. Keating a judgment question. I asked some of the officials from the Bank of Boston over a year ago when they appeared before our committee, I used the term money laundering during a point in the testimony and I asked them if they felt the Bank of Boston had been engaging in money laundering. And they said, no, we absolutely have not.

From your knowledge of that situation, do you agree with their statement?

Mr. **Keating**. That predates my tenure as Assistant Secretary. I'd rather avoid that question, if I could——

Ms. **Kaptur**. Withold comment on that.

Mr. **Keating**. Because I really don't know the facts with specificity.

Ms. **Kaptur**. I remember their answer. I was a little bit surprised.

Do you happen to know where the term smurfing came from. Isn't smurf that blue icecream that they sell? Is that where the term came from?

Mr. **Keating**. That's my understanding. That was asked during the break here and I found out from Mr. Stankey that that was the origin of the term. What relevance that has to the practice, I don't know, but I understand that's where it came from.

Ms. **Kaptur**. Mr. Stankey, do I take it you might have an opinion on that?

Mr. **Stankey**. As I understand it, it originated in the cases in Florida where they had a number of people involved in laundering small amounts of money, the little people in the organization. And someone said, well, they're like smurfs. They're running around every place.

Ms. **Kaptur**. Oh. So it comes not from blue icecream, but from little smurfs.

Mr. **Serino**. The cartoons, the smurfs.

Ms. **Kaptur**. Oh. All right. I get it. This is not something I'm real familiar with. [Laughter.]

I wanted to ask you, somewhere in your testimony, Mr. Keating, you referred to, and I can't find the cite. I know I read it here. There were about 138 institutions that had somehow been involved in this type of activity.

Mr. **Keating**. My testimony referred to, since the *Bank of Boston* case, the Office of Financial Enforcement within Treasury has had some 60 financial institutions come forward to discuss with us their noncompliance with the Bank Secrecy Act. Of those, some 16 have paid civil penalties, ranging anywhere from $112,000 to $4.75 million.

Ms. **Kaptur**. I wanted to ask you, as you're attempting to enforce this, is there a geographic concentration to where those institutions are located? Or are they pretty much spread across the map?

Mr. **Keating**. My understanding is, Congresswoman, that they are not geographically centralized at all. They're all over the United States.

Ms. **Kaptur**. I want to also commend you for including casinos in your regulatory process. I'm wondering, in addition to the witness, I was not able to be here yesterday, Mr. Chairman, to hear the witness that testified on the Wilshire Boulevard scandal. But I'm wondering, Mr. Keating, if you could perhaps use one or two other examples to enlighten me on what happens.

I doubt that any Toledo, OH, bank, which is the region of the country that I represent, would be at your doorstep. But could you explain to me in simple terms exactly how this works?

Mr. **Keating**. Well, of course, as several of the members, including Mr. Wylie, have made reference, narcotics trafficking is primarily a cash enterprise. In order to move large sums of cash around—as high as $110 billion a year expended by American citizens on narcotics—huge, bulky quantities of cash in denominations no larger than the $100 bill have to be moved through financial institutions and shrunk down, if you will, to passable mediums of exchange, such as cashier's checks or bank checks, or what have you.

In order to avoid the spectre of law enforcement and also the IRS, these money-laundering enterprises do go on, where these large amounts of cash are exchanged for monetary instruments, drafts, cashier's checks, what have you.

Ms. **Kaptur**. They just walk up to the window?

Mr. **Keating**. Well, that's one way that it's been done.

Ms. **Kaptur**. They establish accounts?

Mr. **Keating**. Well, in some cases, certainly they do. In many cases, they don't. It varies.

Maybe some of the other members of this panel might be more in a position to share some anecdotes.

Ms. **Kaptur**. So, somehow, in the case of drug dealers, they would get someone to walk into a financial institution and exchange the money or put it in large denominations or——

Mr. **Keating**. Yes. That's my understanding of what occurred yesterday, that the testimony was about an individual who went to a variety of California banks and exchanged cash for cashier's checks, which obviously are much less burdensome to carry around, and then was able to move the money in and out of the country or in and out of other banks or other States that way.

Ms. **Kaptur**. I see. I just wanted to make one final statement. We certainly welcome you aboard and wish you well. I'm interested in Mr. Wylie's statement about making sure that all of you have the enforcement staff that you need in this area in the Gramm-Rudman era.

But I wanted to say something particularly to Mr. Stankey because I'm a fairly new member of this committee. This is only my second term. We see a lot of people on all the committees that I serve on that serve the people of the United States.

I will never forget your testimony, a very humble person. I remember your appearance before our committee last year. And I want to thank you on behalf of the people of the United States for your service to them. You are a rarity in this Government and I think that we don't do enough to recognize people like yourself who have served. And you didn't go out and go work for some foreign interest for $300,000 after you'd served the Government of the United States for 2 years. You continued to serve the people of this country.

I think you should be recognized and thanked for that service. Much happiness and health to you in the years to come.

Thank you, Mr. Chairman.

Mr. **STANKEY**. Thank you very much. That's very kind of you, Ms. Kaptur.

Chairman **ST GERMAIN**. Mr. Wortley.

Mr. **WORTLEY**. Thank you, Mr. Chairman.

Too bad we can't do a 1-minute for Mr. Stankey on the floor today because everybody has applauded him. But I, too, would like to say what an exceptional public servant he is and what a precious resource you've been to the Government.

Also, you've been a very wise and good counselor to many of us on this committee, particularly myself. I wish you well and the very best of everything in the future.

You're a great public servant.

Let me go to Mr. Keating for a moment. Mr. Keating, does the Treasury Department sit in with the central bankers of Europe and the bank for international settlement? Do you sit in as an advisor or an observer?

I know we're not a member of the bank of international settlement, but I do know Mr. Volcker goes over there. Does somebody from the Treasury Department also participate?

Mr. **KEATING**. Mr. Wortley, I don't know. But let me see if any of my colleagues would have the answer to that.

[Pause.]

Mr. **KEATING**. Mr. Stankey, since he's in good graces, I'll quote him. Mr. Stankey says he thinks so, but he's not sure. I can find out, Congressman.

Mr. **WORTLEY**. Well, this whole business of money laundering, it ultimately goes through the international process some place before it recycles and comes back to this country.

I've spoken to Chairman Volcker and also corresponded with him and asked him if he could not put the subject of money laundering on the agenda, even though we are not official members of the bank of international settlements. When the central bankers meet, I think that this ought to be a very high priority matter.

And it would seem to me that the U.S. Department of Treasury, who, as you sit here today and express your concerns, should also attempt to get the central bankers of the world and the bank of international settlements to give serious focus to this issue.

I wonder if you could respond to me at a later date. I would urge you to bring whatever pressure you have to bear to making certain that the international bankers raise their level of awareness in the area of money laundering.

Mr. **KEATING**. Congressman, your suggestion has a great deal of merit and I assure you I'll talk to the Secretary about it.

Mr. **WORTLEY**. Thank you very much.

Mr. Dudine, you state on page 1 that a great majority of BSA violations represent inadvertent failures to follow bank procedures and incomplete or flawed CTR filings rather than actual failures to file.

Do you want to be a little more specific about that? Where does the breakdown come?

Mr. DUDINE. The report that we provided the committee, in exhibit I, breaks down our violations according to a couple of categories. And our statistics are based on those particular categories.

Unfortunately, the category includes failures to file, as well as incomplete and late filings. We have corrected that, but the data are not available for 1985. We will be able to——

Mr. WORTLEY. Can you get us that data a little later?

Mr. DUDINE. The only thing I can give you are the results of an inquiries we made with our regional people and some of our examiners that actually go out and do the examinations. Their general feeling is that the overwhelming majority of the violations are incomplete reports and late filings and not failures to file. Failures to file, when they are detected, are, for the most part, inadvertent failures and that the bank then files as soon as the failure is noticed.

So we have a very small percentage of situations of wilful failures to misfile a report. These are based on our examination results.

And you have to understand that when we do an examination, we look at a slice of transactions maybe 2 weeks out of a period of up to 3 years nowadays because of our lengthening examination cycles.

So we don't have a tremendous amount of coverage of all of those transactions to begin with.

Mr. WORTLEY. You're saying that you do not analyze all of those transactions as they come through to you. You only do random checking?

I mean, this is almost like the IRS. They don't examine every tax return. They only——

Mr. DUDINE. Yes, that's correct, Congressman. We must rely on the internal systems of the banks themselves and their internal audit departments to actually enforce compliance with the rules. And then we go in periodically, just as a check.

Mr. WORTLEY. The banks' internal systems sometimes leave something to be desired.

Mr. DUDINE. Yes, sir, no question about it.

Mr. WORTLEY. Especially in Boston. I have another question for Mr. Woodard of the IRS.

Mr. Chairman, may I have an extension of another moment or two?

Chairman ST GERMAIN. [Nods in the affirmative.]

Mr. WORTLEY. Thank you. The Bank Secrecy Act defines coverage to include the obvious financial institutions, in addition to entities such as pawnbrokers and loan and finance companies.

However, the regulations of Treasury adopted pursuant to this act narrow that suggested list down. For example, loan and finance companies are not required to file CTR's. Instead, the institutions of this type are required to report cash transactions in excess of $10,000 pursuant to the IRS regulations.

The IRS regulations requires information returns to be filed within 15 days for transactions in excess of $10,000. Two or more related transactions must be aggregated and reported.

For example, must they provide a statement for each person showing the aggregate amount of reportable cash received from a person over a calendar year? What is the period that they talk about when they aggregate?

I can't understand the justification.

Mr. **Woodard**. As I understand the reporting requirement, the aggregate is over a 24-hour period.

Mr. **Wortley**. Just within a 24-hour period?

Mr. **Woodard**. Yes, sir.

Mr. **Wortley**. Does the IRS ever look at the cost effectiveness of this?

Mr. **Woodard**. I'm not sure I follow the question.

Mr. **Wortley**. Well, I'm reading the regulation. It says, "any person required to make an information return under section 6050I must also furnish a statement to any person identified on a return showing the aggregate amount of reportable cash received from that person. The statement must be furnished on or before January 31 of the year following the calendar year in which the cash is received."

That doesn't sound to me like it's the amount of money received within a 24-hour period. It sounds to me like it's the aggregate of cash received over perhaps an entire calendar year. That seems to be a little far-fetched.

Mr. **Woodard**. To be sure that I'm responsive to that question, let me look back at the background on that regulation and see if we can't get you an answer.

Mr. **Wortley**. Yes, could you clarify that one because it looks to me like maybe you're spinning your wheels a little bit——

Mr. **Woodard**. Yes, sir.

Mr. **Wortley** [continuing]. If you're taking your valuable time for people to see how much cash is transacted over a whole period of a year.

I understand 24 hours. Maybe even 48 hours. But the way the regulation is written here would imply that you're talking about the aggregate amount of cash over an extended period of time.

If you could give us a clarification on that, we'd sure appreciate it.

Mr. **Woodard**. Yes, sir, we will.

Mr. **Wortley**. Thanks very much.

Thank you, Mr. Chairman.

[In response to the request of Congressman Wortley, the following information was submitted for the record by Mr. Woodard:]

Clarification of IRC 6050I Reporting Requirements

Internal Revenue Code (IRC) section 6050I requires that an information return must be made by any person who, in the course of a trade or business in which such person is engaged, receives cash in excess of $10,000 in one transaction (or two or more related transactions). The regulations under this section provide additional guidance on related transactions.

The regulations under IRC 6050I require that a return (Form 8300, Cash Payments Over $10,000 Received in a Trade or Business) be filed with the IRS on related cash transactions (two or more cash transactions) occurring within a 24-hour period, on a series of connected cash transactions, or on multiple cash payments. Depending on the particular circumstances, the cash received will be aggregated and reported as a single transaction on one Form 8300.

For example, if an individual purchases two items for cash at a cost of $5,000 and $9,000, respectively, at a 1-day auction, the auction house is required to report the total of the cash received from the two related sales ($14,000) as a single transaction.

In addition, cash transactions occurring beyond the 24-hour period, which are a series of connected transactions, must be reported as a single transaction if the recipient of the cash knows, or has reason to know, that they are related. For example, three cash sales of $9,000 each by a coin dealer to the same person, on consecutive days, would be reported as a single cash transaction of $27,000 on Form 8300 if the dealer knows or has reason to know that each transaction is one of a series of connected transactions.

Multiple payments, such as installment payments, relating to the same transaction (or related transactions), are reported in three different ways depending on the amount of the intial and subsequent payments.

In addition to filing a Form 8300 on specific cash transactions, such as the ones described, the person receiving the cash must provide a single, written, annual statement to any person identified on the form. This annual statement must show the aggregate amount of cash received from the person during the calendar year.

As you will note, the Form 8300 is a report of the actual cash transaction which took place, whereas the annual statement is a summarization of all cash received from a particular person during the year.

Chairman **St Germain**. Mr. Torres.

Mr. **Torres**. Thank you, Mr. Chairman, again for allowing me to participate in your subcommittee.

It's been pointed out today by Mr. Keating that I have legislation that's been put forth. The chairman is a cosponsor of this legislation, to begin to deal with this very serious problem that's pervasive around this country.

Indeed, yesterday, I heard from the key witness who described the modus operandi of smurfs and how they operate in laundering money.

I can't help but say, and I know I'm joined by some of our colleagues, that it was unbelievable evidence. It was just something mind-boggling, to find out exactly what is now taking place through our financial institutions, and the use of drug money, which it's been proven that that's what it is, and it's being washed through or laundered through our financial systems.

My colleague from Ohio, Ms. Kaptur, asked earlier if—she wasn't here yesterday—and I would just like to point out to her that photograph on the left-hand side over here, that that was the amount of money that they found in one laundering operation in 1 day, and that money there was surplus money that was on hand that they weren't able to launder that day. That's just the surplus money there, amounting to some millions of dollars found in this one warehouse where they do this.

The most appalling part of this is the sort of blase, if you will, willy-nilly attitude of banking management and tellers and bank officers toward this problem.

We heard that smurfs can go into any bank and if they launder anything under $10,000, there's no questions asked. The same persons go in and out, take in shopping bags full of money, no ID required.

Hundreds of millions of dollars is being laundered in this way.

In Los Angeles, the area that has now become one of the top areas of money laundering, recently, smurfs laundered millions of dollars. And when the authorities took them to court, when the Government stepped in, they were tried and convicted of this crime.

Well, the circuit court of appeals overturned the court's ruling and said that these people were innocent because they'd broken no laws. There are no laws against people laundering anything or buying certified checks under $10,000, that the banks weren't required to record this, so therefore, they broke no laws. So they're scott free today.

As I said, the system is pervasive across this country. It's raising havoc in our financial institutions. And I look at your testimony and you cite my particular legislation, H.R. 4280. You believe that a regulation is far better than a legislative statute.

I fail to understand why we would want a regulation as opposed to law, the law that makes the kinds of actions that I just described illegal and punishable under the law.

Moreover, in your testimony, you talk about the cost of administration that this will create on the financial institutions.

I know of one bank in California that was fined $4½ million because they didn't report certain deposits over $10,000, which is required by law.

So we talk about cost, I think the cost is being assessed to banks who are not following the law. This cost is going to be passed on to the consumer.

What is your feeling about this regulation versus a statute?

Mr. **Keating**. Well, Congressman, the discretion rests with the Congress to pass any statute which will assist law enforcement in their efforts to curb this activity. And I, for one, compliment you for your interest and the other members of this committee in this issue.

We may respectfully disagree as to certain paragraphs or certain approaches to the law, but I think that you're to be commended for being interested in helping us solve the problem.

All of us here, individually and collectively, are urging the Congress to pass the money-laundering statute, which is an enactment of the Congress and will make money laundering, per se, a crime.

We feel that the urgency of the problem mandates a regulatory response at this time. Now, obviously, if the Congress is interested in proceeding with legislation, that is their prerogative. But within the next few weeks, we will have a proposed regulation ready to address the smurfing problem as well as to address the cashier's check problem. We expect probably a 290-day public comment period and then the implementation of that regulation.

We are concerned about the impact on the financial community. We feel that whatever is done must have a legitimate law enforcement purpose and must be able to realize highly useful legitimate law enforcement and tax enforcement information. It may be that the threshold is too low. It may be the threshold is too high. We may disagree on that.

But I think that certainly, our interest is not to destroy the financial institution, but to require compliance and to assist us in our effort to stop this $110 billion traffic.

Mr. **Torres**. Thank you, Mr. Keating. Thank you, Mr. Chairman. My time has expired.

Chairman **St Germain**. Gentlemen, to refresh your memory, the Financial Privacy Act of 1978 was passed in large part as a result of, or in answer to, a Supreme Court decision involving the *United States* v. *Miller*.

The Court, in that case, held that citizens had no property or privacy interest in their bank records. Now the act overturns that decision.

I mention this, at this time, because here we are, 10 years later, and all of you are endorsing the administration's Right to Financial Privacy Act amendments, claiming, in a general way, before us that current law has created clear impediments to criminal law enforcement efforts.

I would like each of you to be more specific and tell the subcommittee what those clear impediments are.

We'll start with Mr. Serino.

Mr. **Serino**. Thank you, Mr. Chairman.

One of the impediments we see is our inability to communicate directly with law enforcement when we make criminal referrals, for instance. There is a limitation on our being able to provide at that time full detailed factual situation of a particular transaction, if it involves customer records.

No. 2, we cannot transfer at that time to the Justice Department copies of any documents that we may have obtained during——

Chairman St Germain. Yes, but what you're telling me about is transfer, and you have the documents.

Mr. Serino. That's correct.

Chairman St Germain. So what is that? We provided in that act that there had to be notice, and if there are exceptions to notice—that's what I'm asking you about. What is there in that act? That act is not the impediment to your communicating; is it? There's nothing in that particular act, the Financial Privacy Act——

Mr. Serino. Yes, there is, Mr. Chairman. In order for us to transfer that information that we get through the examination process to the Department of Justice, we have to give notice to a particular customer that we're transferring this information to them, to the Department of Justice.

Chairman St Germain. But the Government can obtain a delay of notice; can it not?

Mr. Serino. In certain instances. In certain instances.

Chairman St Germain. In which instances?

Mr. Serino. Well, I believe they have to go to court and they have to establish that there is——

Chairman St Germain. The possibility of physical injury to a person, flight from prosecution, destruction or tampering of evidence?

Mr. Serino. Exactly.

Chairman St Germain. Or that notice would otherwise seriously jeopardize an investigation or official proceeding?

Mr. Serino. Right.

Chairman St Germain. Now that's pretty broad.

Mr. Serino. It's pretty difficult to have to do that every time you want to make a transfer.

Chairman St Germain. So you're saying there should be no notice whatsoever?

Mr. Serino. The point I make is this—that once the information is legally in the hands of the Government—if we get it through our examination process, it is legally in the hands of our officials, we should be able to transfer it to another agency of the Government without giving notice.

That's my position.

Chairman St Germain. Mr. Dudine.

Mr. Dudine. There are a couple of problems with the Right to Financial Privacy Act. The main one may be that its provisions are somewhat confusing.

We found that within the bank regulatory agencies themselves, when we got together in the bank fraud working group, that we had no less than four different interpretations as to how we could do a criminal referral under the Right to Financial Privacy Act.

At a minimum, I would hope that we could get some sort of clarification of what the Congress intended us to do in connection with criminal referrals.

The Justice Department prefers that notice not be given in any case where a bank regulatory agency discovers something that might be a crime against a bank. Therefore, in order to make a criminal referral in those kinds of situations, the FDIC has been following some of the other agencies are not even following the Justice Department guidelines—the Justice Department guidelines, issued in 1979, stating that the amount and type of information that could be supplied without making notice to the customer, a minimal amount of information.

The Justice Department then takes the information and turns around and in almost all cases any more, issues a Federal grand jury subpoena so that the customer or the target would come under the provisions of the Federal grand jury process.

What we would like to be able to do, particularly in a case where the crime is against the financial institution and involves an insider of the institution, we feel we ought to be able to make a more informative referral at the time of detection without having to notify the individual.

In most cases, criminal referrals are going to involve insiders of the institution. The provisions in the administration's bill would correct that situation.

There's another situation we have commented upon in the past and that is a case where customers' of bank accounts have been manipulated by an insider. In order to transfer that information to the Department of Justice for them to make any kind of a determination whether to proceed with an investigation——

Chairman **St Germain**. The notice goes to the customer; doesn't it?

Mr. **Dudine**. We would have to notify customers.

Chairman **St Germain**. What's wrong with that?

Mr. **Dudine**. The customers are not involved in the crime. Their accounts may have been manipulated. And certainly——

Chairman **St Germain**. But you're still releasing that customer's bank records.

Mr. **Dudine**. We, in most cases, would be releasing just a summary of them.

Chairman **St Germain**. But, we went through this when we considered the act 10 years ago, Mr. Dudine.

You give me your canceled checks and, boy, I can tell a lot about your life; can't I?

Mr. **Dudine**. These are cases, Mr. Chairman, where the customer is not the target of the investigation.

Chairman **St Germain**. But the fact of the matter is that a customer's private life is being disseminated around the block. What difference does it make?

Don't you like a little privacy in life?

Mr. **Dudine**. It's not exactly around the block. They are being transferred to the Department of Justice for a legitimate law enforcement purpose.

Chairman **St Germain**. Mr. Dudine, we hear about leaks from grand juries constantly; don't we? Absolutely. And we have an obligation to be very cautious in this area.

You have to make a strong case here because, otherwise, we ain't about to change it. This is one of those that's going to be very controversial, I might say, so if we are going to go the legislative route, this is one that we probably won't touch at this point in time.

Anybody else want to add anything to that which has been volunteered by Mr. Serino and Mr. Dudine?

Mr. **Passarelli**. I want to add one point that wasn't mentioned. You know, we can exchange this information with the state officials. The act was amended in 1982 to actually exchange this information with the State officials.

Chairman **St Germain**. With the State examiners?

Mr. **Passarelli**. Yes, that's right.

Chairman **St Germain**. But that's nothing new, because they can go in and examine also.

Mr. **Passarelli**. Right.

Chairman **St Germain**. If it's State chartered.

Mr. **Passarelli**. That's right.

Chairman **St Germain**. Only if it's State chartered.

Anyone else want to add to this?

Mr. **Keating**. Mr. Chairman.

Chairman **St Germain**. Mr. Keating.

Mr. **Keating**. I'd like to mention, my reading of the proposed amendment in the administration bill—that is, 1103(c)—does not do major disservice to what you are attempting and to what you believe in, and I think quite legitimately.

The present language reads that the Government can be provided information by the bank, and the quote is, "which may be relevant to a possible violation of any statute or regulation."

At the present time, as a result of interpretation by bank counsel, I'm informed that many banks are hesitant to provide any information, even under that exemption, if you will, because of the fear of civil liability.

So what we are hoping is that that particular provision will be explained, that if there is evidence of a criminal violation, in this case, of course, we're most interested in a money-laundering violation, that with a good faith defense, the bank can provide a limited amount of information to permit the law enforcement authorities to obtain a summons or a grand jury subpoena to further investigate.

And we think that that is merely an expansion, really, a creditable expansion of what really was intended by the Congress when the act was initially passed.

Chairman **St Germain**. Staff informs me, and I think makes a good point, that there are those who feel that in this very selfsame bill, the definition of money laundering is very, very broad, exceptionally broad.

So when you combine the two, it gives us reason to pause and hesitate.

Mr. **Keating**. Well, as the chairman is aware, that the committee is in a position to do some minor or major surgery on that. I think that definition is in the title 18 provisions which were drafted by Justice.

We certainly are in agreement with your very legitimate concerns. But by the same token, we feel that we should be able, under unusual circumstances and for a very real, legitimate law enforcement purpose, to have access to some of this information which will help us.

Chairman St Germain. Mr. Passarelli, did you have anything further to add?

Mr. Passarelli. Excuse me?

Chairman St Germain. Did you have anything further to add?

Mr. Passarelli. No, sir; thank you.

Chairman St Germain. Gentlemen, now we are going to ask this of the Department of Justice as well, but maybe you could tell me why you feel that the Justice Department or Government has rarely invoked the right to override the notice requirement.

A 1984 report on applications for delays in notice and customer challenges on the provisions of the Right to Financial Privacy Act of 1978 states the Federal Government requested delayed customer notices in only 10 cases, all of these having occurred in the State of Nebraska.

As a matter of fact, the report indicates that the Government has filed only 30 delayed notice applications, including the 10 in 1984, since the year the act went into effect in 1979.

Could you tell us why you feel that there are so few notice delays requested in that 5-year period?

Mr. Serino.

Mr. Serino. I don't particularly know, Mr. Chairman, but I would suggest that perhaps it may be because they've obtained the records through the grand jury process. If they have obtained it through the grand jury process, they do not need to request any notice.

Chairman St Germain. Does anyone else have any thoughts on that?

Mr. Dudine. I would say that's a good possibility. And also, the Justice Department has, I believe, taken a pretty firm position of trying to work around that whole process.

Chairman St Germain. Mr. Dudine, you told us in your testimony about the strategy at the FDIC of focusing the examination efforts on banks diagnosed as most likely to have Bank Secrecy Act compliance problems.

Now what criteria do you use to make this determination? Can you give us a profile of a bank that would be most likely to exhibit this type of compliance problem?

Mr. Dudine. Well, the first thing we would be looking for would be a bank that ships a lot of currency in or out of its system.

The Customs Service is doing some work now in relating currency transaction reports to the amount of cash shipments made to and from the Federal Reserve. Their analysis kicks out the banks that are not reporting CTR's in proportion to the amount of currency shipped.

In other words, they're doing mean variance analysis and are kicking out the banks on both sides, the ones that are reporting a lot of currency transactions and also those that are shipping currency and are not making the reports.

This gives us at least an indication before we target a bank for an examination, that we will be going into a bank that is, in fact, shipping a lot of currency, or more than the normal situation.

Chairman **St Germain**. How long have you had this in effect, this pattern, so to speak?

Mr. **Dudine**. It's just in the early stages and we've only received reports, to the best of my knowledge, in a couple of states. But it's something that Customs is working on.

Chairman **St Germain**. So you're not in a position, therefore, to tell us whether it's efficacious.

Mr. **Dudine**. Intuitively, it would seem to be an intelligent way to target banks.

Chairman **St Germain**. Sounds good. I just wondered if you had any—we may well ask you about 6 months from now to give us a report, without naming the institutions, on how this is working out.

Mr. McCollum.

Mr. **McCollum**. Thank you, Mr. Chairman. I'm sorry I had to go in and out during this hearing, but I appreciate the chance to ask a few questions.

Mr. Keating, with regard to the Bank Secrecy Act reporting exemption, I understand at the present time that this is a discretionary matter with respect to each individual bank as it applies the exemption or doesn't to business customers who deal in large amounts of cash because they maybe have a store, whatever it is, that just simply is not practical to have them comply since they have such daily high cash transactions.

It is my understanding that the customer does not apply, does not request, is not involved, that it's a decision made at each bank.

Would you have any problem if we enacted in legislation a requirement that each of the customers who are given an exemption be required to apply, if you will, sign a form for, and state on that form their purpose in requesting it so that we would have a record that clearly indicates their intent, perhaps even with a perjury concept in it?

Would you have any problem with that?

Mr. **Keating**. It sounded good to me, Mr. McCollum, but I wanted to talk to my father confessor, Mr. Stankey, back here before I answered.

I think that sounds like a very fine suggestion and we may even look at that from the regulatory side.

But we think that that's a very fine suggestion.

Mr. **McCollum**. As you're aware, I've spent sometime on the money-laundering question and that issue has occurred to me during the course of that. I haven't had a chance to discuss it with you before, but since we may markup a bill in this committee before we do in the other one I'm working on it with, and it's certainly pertinent to this committee, I thought I'd ask it.

You were in law enforcement for quite a while, as I recall, am I not right, Mr. Keating?

Mr. **Keating**. Yes, sir.

Mr. **McCollum**. And in that process, you had to deal with the determination of when to go to a judge and seek a subpoena in a criminal prosecution, did you not?

Mr. **Keating**. Yes, I did.

Mr. **McCollum**. And isn't one of the major concerns that you and others in the Treasury have in the area of the question of the right to financial privacy and the disclosure of information by banks, isn't one of the primary concerns you have with getting enough data to red-flag for any law enforcement person, that they should go seek that subpoena because of the volume of material that otherwise could be presented.

It isn't just a question of getting the banks to forthcome with any kind of information, but it's a question of whether they come forward with the right information to let you know that that particular one is worth looking at.

Isn't that part of this issue?

Mr. KEATING. Yes, Mr. McCollum. And as I indicated to the chairman, I think what we want to do is to permit the opportunity for good citizens to be good citizens and not to be sued for being good citizens.

And in cases such as you are citing, if evidence comes to the attention of the bank suggesting criminal conduct, we think that if they could provide the U.S. attorney, for example, or some other Federal law enforcement agency, information sufficient to get a summons or a subpoena to continue the investigative process. That would be beneficial.

Mr. MCCOLLUM. But if they're just giving you some of the information you've seen up until now, that's not enough. You need something more to know that that is one worth pursuing out of the thousands of possible pieces of information you get.

Isn't that part of the problem for any U.S. attorney?

Mr. KEATING. Yes, Congressman. I also understand that part of the problem is we're getting no information.

Mr. MCCOLLUM. All right. Let me ask you another question related to that.

I know this is a delicate area and right to privacy of the citizen customer is a very important issue to me, as well as to the chairman.

What can we do, though, to give you that information that does not necessarily require or allow the bank to turn over whole lots of records that we wouldn't want turned over?

Is there some way we could craft specific guidelines for a summary and limit the amount of information that the bank could give, but still give enough for this purpose?

Mr. KEATING. Congressman, I don't have a copy of the administration's-backed proposals which I have reviewed during the course of last week or so. What is set forth in those proposals for amendment to 1103(c), I believe do provide those safeguards and do carefully attempt to protect the privacy interest which the chairman most properly is concerned about.

Mr. MCCOLLUM. Well, I am, too, and I want you to know that I'm willing, and I know he is, to work with you or whoever, but we've got to be sure that those guidelines are tight enough.

I will tell you right off, and I've told people down at Justice, too, that the details of what's come down here on many occasions are simply not sufficient. And that's why we're worried as we go to mark up about getting the right language.

I think the ideas are important, they're there. And most of us agree on the ideas. It's just a question of not having the right language to be specific enough.

Well, I thank the chairman for the time. I think those are two important points and I appreciate the opportunity to question on them.

Chairman St Germain. I'd like to make an observation. I just consulted with some of my staff who are more currently involved in the law than I am, my not having practiced for a long period of time, and they confirmed my thought.

If Mr. Keating accuses Mr. Dudine of a crime and goes to the authorities and gives false testimony or does it without good faith, and Mr. Dudine is then found to be innocent, Mr. Dudine can then sue Mr. Keating; can he not?

The answer is yes.

Mr. Keating. Of course it depends——

Chairman St Germain. In civil liability; right? Absolutely. So now, what we're saying is, well, we're going to give the banks a little more. We're going to give them a little immunity that John Q. Citizen, who wants to be a good citizen, and who feels that he is aware of a crime or a criminal act having been committed, won't have. We are going to protect that bank more than we would protect the good citizen; right?

Maybe I'm wrong, but that seems to be the case here, or could be the case here.

Mr. Keating. Congressman.

Chairman St Germain. You don't think we should protect the bank more than we protect an ordinary, good citizen from being a good citizen; do you, Mr. Keating?

Mr. Keating. No, sir, I don't, and I don't think we're doing that here. I think it varies, of course, from State to State.

But in my State, in Oklahoma, to sue someone successfully for abuse of process, you have to show that there is no legitimate basis for the allegation, absolutely no legitimate basis.

Chairman St Germain. Well, the same would apply to the bank; wouldn't it?

Mr. Keating. In effect, it was a totally libelous or a slanderous act to start.

Chairman St Germain. The same would apply to the bank; wouldn't it?

Mr. Keating. Certainly.

Chairman St Germain. That's my point.

Mr. Keating. Or it should.

Chairman St Germain. Mr. Wylie, do you have something else?

Mr. Wylie. Yes, thank you, Mr. Chairman. This has been a most fascinating panel again today. I would have to say that yesterday, we heard some of the most mind-boggling testimony I've ever heard since I've been on this panel. We heard Mr. Freidberg say that he could walk into a bank several times in the same day with $9,000 in cash and come out with cashier's checks.

Now, apparently, the employee involved was not dishonest, but perhaps should have been a little bit more alert and maybe there should have been some procedure to do that.

But Mr. Serino, along those lines, you note in the attachment in your testimony today that the OCC is currently considering specific recommendations or modifications in the Change in Bank Control Act. This is an area that several of us on the committee, including the chairman and Mr. Wortley and myself, have had a keen interest in, trying to find a way to hault the dishonest individual from obtaining control of assets of a bank that can be used in money laundering.

Maybe that wouldn't get to the problem that I alluded to here with Mr. Freidman a little while ago, but at least it would raise a red flag and maybe alert the employees in the bank, that they should be aware that this law exists.

But back in 1985, in May, I wrote to Mr. Conover and asked him for some recommendations as to the amendments of the act, and I got a letter back from Mr. Mancuso in September. I thought by this process today that I would let you know that I'm going to send a letter to Mr. Clark and ask him to comment on Mr. Mancusi's proposal.

Chairman **St Germain**. Is Mr. Mancusi still there?

Mr. **Wylie**. Is he still there, Mr. Mancusi?

Mr. **Serino**. Mr. Mancusi has left the office, Mr. Wylie.

Chairman **St Germain**. So he won't be able to ask Mr. Mancusi to comment?

Mr. **Wylie**. No, I want Mr. Clark to comment on Mr. Mancusi's letter.

Well, thank you, Mr. Chairman.

Chairman **St Germain**. Ms. Kaptur, do you have any further questions?

Ms. **Kaptur**. Mr. Chairman, I just wanted to ask one further question, and that is of anyone on the panel.

What have you found to be under existing law or regulation the most effective way of determining where money laundering and smurfing are going on? And we reviewed a lot of current authorities in your testimony and we talked about proposed authority. But what has been the most effective at this point?

I'm just curious.

Mr. **Serino**. One of the things that has been helpful to us is the Customs studies that they've done to compare the cash that's taken out of banks with the CTR filings that those particular banks have filed to see whether or not——

Ms. **Kaptur**. What was the first thing? You said Customs?

Mr. **Serino**. The Customs Service has done studies periodically, they evaluate the amount of cash that comes into the Federal Reserve banks. It pinpoints those banks that are giving off a lot of cash to the Federal Reserve banks. They look and compare the CTR filings to see whether or not those banks that are depositing large sums of money in the Federal Reserve are also filing the CTR's.

Ms. **Kaptur**. If I might interrupt just a second, Mr. Chairman, wasn't that how the Bank of Boston, through the Fed, wasn't that the way that we found out about that?

Am I wrong?

Mr. **Serino**. That's correct.

Ms. **Kaptur**. That was through the CTR.

Chairman **St Germain**. [Nods in the affirmative.]

Mr. **Serino**. That's correct. In fact, that was the genesis, I think, several years ago of the Operation Greenback down in Florida that we've heard about for years, that that was how we were able to target certain institutions.

Ms. KAPTUR. Mr. Keating, did you want to add something to that?

Mr. KEATING. I would say that what Mr. Serino just told you is the most important feature that we have been able to use for intelligence purposes, that Customs program of monitoring the flows of currency in and out of the system.

Ms. KAPTUR. Thank you. Thank you, Mr. Chairman.

Chairman ST GERMAIN. Thank you. Naturally, I've already expressed my joy at the fact that there's more communication going on. But I would bring one last item up as we come to the conclusion of this hearing.

Just last summer, in the case of Golden Pacific, the OCC, which was the primary regulator of Golden Pacific, referred the bank to Justice. Justice then proceeded to later on inform the Federal Reserve that it was dropping its investigation shortly before the Fed approved Golden Pacific's bank holding company application.

The peculiar thing is that Justice never told OCC that it had dropped its investigation. And of course, OCC was the agency that had referred the matter originally to Justice.

I hope that when you convene this interagency group, you remind them of this one as well, Mr. Keating, so that they can understand the importance of communication.

I'm about to conclude the hearing. However, I would say that I would ask for unanimous consent that we be permitted to address additional written questions to the panel and would also ask that you try to get back to us as promptly as possible with those questions that have a bearing on the legislation that we are considering.

Some of the questions pertain to the issue of background on records. That's not as important. But the important ones are the questions that bear on the legislation that we'd be considering because, as I told you, I'm going to try to do something in the early future.

So, again, we thank you for your participation, your assistance, and your cooperation.

The subcommittee will be in recess, until the call of the Chair.

[Appendix material related to this day, was submitted by the subcommittee for inclusion in the record follows:]

[Whereupon, at 12:25 p.m., the subcommittee was in recess, to reconvene subject to the call of the Chair.]

APPENDIX

STATEMENT OF

PERCY P. WOODARD, JR.
INTERNAL REVENUE SERVICE
ASSISTANT COMMISSIONER (EXAMINATION)

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

ON THE
HEARINGS TO PROTECT AGAINST
FINANCIAL INSTITUTIONS BECOMING
HAVENS FOR TAX EVADERS, DRUG TRAFFICKERS
AND LAUNDERERS OF FUNDS DERIVED FROM
CRIMINAL ACTIVITY
APRIL 17, 1986

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE

I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS EXAMINATION'S ROLE BOTH WITH RESPECT TO THE INTERNAL REVENUE SERVICE'S RESPONSIBILITIES UNDER THE BANK SECRECY ACT AND ITS MISSION. AS YOU WELL KNOW, DURING THE PAST YEAR, TWO MAJOR EVENTS HAVE SUBSTANTIALLY EXPANDED THE SERVICE'S AUTHORITY UNDER THE BANK SECRECY ACT. THE FIRST WAS THE PUBLISHING OF NEW TREASURY REGULATIONS BRINGING CASINOS, PREVIOUSLY EXEMPTED FROM THE BANK SECRECY ACT, UNDER SUCH ACT. THE SECOND WAS THE ISSUANCE, BY THE ASSISTANT SECRETARY (ENFORCEMENT AND OPERATIONS), OF TREASURY ORDER 105-13, WHICH, AMONG OTHER THINGS, DELEGATED TO THE SERVICE THE RESPONSIBILITY FOR REVIEWING EXEMPTIONS FROM THE REPORTING REQUIREMENTS OF THE BANK SECRECY ACT AS WELL AS APPROVING SPECIAL EXEMPTION REQUESTS PURSUANT TO CURRENT REGULATIONS.

IRS' EXAMINATION FUNCTION

MY COMMENTS TODAY WILL FOCUS ON THE MISSION OF EXAMINATION; THE RANGE OF ACTIVITIES THAT EXAMINATION IS INVOLVED IN; A DISTINCTION OF EXAMINATION'S AUTHORITY UNDER THE BANK SECRECY ACT FROM THAT OF CRIMINAL INVESTIGATION AND THE OTHER SUPERVISORY AGENCIES; AND EXAMINATION'S PLAN TO SYSTEMICALLY UTILIZE THE FINANCIAL REPORTS REQUIRED UNDER THE BANK SECRECY ACT, SPECIFICALLY CURRENCY TRANSACTION REPORTS (CTRs).

EXAMINATION SUPPORTS THE MISSION OF THE INTERNAL REVENUE SERVICE BY MAINTAINING AN ENFORCEMENT PRESENCE AND ENCOURAGING THE CORRECT REPORTING BY TAXPAYERS OF INCOME, ESTATE AND GIFT, EMPLOYMENT, AND CERTAIN EXCISE TAXES IN ORDER TO INSTILL THE HIGHEST DEGREE OF PUBLIC CONFIDENCE IN THE TAX SYSTEM'S INTEGRITY, FAIRNESS, AND EFFICIENCY. TO ACCOMPLISH THESE GOALS, EXAMINATION ON AN ONGOING BASIS WILL:

1. MEASURE THE DEGREE OF VOLUNTARY COMPLIANCE AS REFLECTED ON FILED RETURNS;
2. REDUCE NONCOMPLIANCE BY IDENTIFYING AND COST EFFECTIVELY ALLOCATING RESOURCES TO THOSE RETURNS MOST IN NEED OF EXAMINATION AND TAXPAYER CONTACT;
3. CONDUCT, ON A TIMELY BASIS, QUALITY EXAMINATIONS OF TAX RETURNS AND QUALITY CONTACTS TO DETERMINE THE CORRECT TAX LIABILITY.

THE MAKE UP OF THE PERSONNEL CARRYING OUT EXAMINATION'S MISSION DURING FISCAL YEAR 1985 WAS APPROXIMATELY 13,500 REVENUE AGENTS, 3,500 TAX AUDITORS, AND 11,900 OTHER SUPPORT PERSONNEL. OUR EFFORTS FOR FISCAL YEAR 1985 RESULTED IN THE AUDIT OF APPROXIMATELY 1.5 MILLION RETURNS AND 804,000 OTHER TAXPAYER CONTACTS. OUR WORKLOAD WAS DRAWN FROM TOTAL RETURN FILINGS OF APPROXIMATELY 130 MILLION. WE ASSESSED APPROXIMATELY $17.7 BILLION IN ADDITIONAL TAX, PENALTIES, AND INTEREST.

IN ORDER FOR EXAMINATION TO IDENTIFY AND EFFECTIVELY ALLOCATE ITS LIMITED RESOURCES TO THOSE RETURNS MOST IN NEED OF EXAMINATION AND TAXPAYER CONTACT, IN LIGHT OF THE LARGE UNIVERSE OF RETURN FILINGS (130 MILLION IN FISCAL YEAR 1985), WE RELY ON NUMEROUS SELECTION SYSTEMS. ONE SUCH SYSTEM IS KNOWN AS THE DISCRIMINANT FUNCTION SYSTEM (DIF). INFORMATION FROM THE TAXPAYER COMPLIANCE MEASUREMENT PROGRAM (TCMP) IS USED TO DEVELOP THE DIF SYSTEM. THE DIF SYSTEM IS THE SERVICE'S PRIMARY METHOD FOR SELECTING RETURNS FOR EXAMINATION. THE DIF SYSTEM COMPUTER SCREENS ALL INDIVIDUAL AND MOST CORPORATE RETURNS TO SELECT FOR EXAMINATION THOSE RETURNS WITH THE GREATEST POTENTIAL FOR TAX CHANGE. WHILE DIF HAS BEEN EFFECTIVE IN IDENTIFYING RETURNS WITH A HIGH PROBABILITY OF TAX CHANGE, THE SERVICE STILL NEEDS SUPPLEMENTAL SYSTEMS THAT IDENTIFY RETURNS FOR SPECIFIC ISSUES OR FOR SPECIAL SITUATIONS.

NON-DIF SELECTION METHODS ACCOUNT FOR ABOUT ONE-THIRD OF IRS AUDITS OF INDIVIDUAL RETURNS. SOME SUPPLEMENTAL SYSTEMS HAVE BEEN IN PLACE FOR SEVERAL YEARS, OTHERS ARE ADDED AS THE NEED ARISES. THE NEED IS USUALLY DETERMINED AFTER THE COMPLETION OF A COMPLIANCE STUDY WHICH WILL PROVIDE DATA ON YIELDS AND COSTS. THESE STUDIES ARE IMPLEMENTED BASED ON KNOWLEDGE OF PROBLEM AREAS OR SPECIAL REQUESTS FROM CONGRESS, OTHER AGENCIES, OR SERVICE MANAGEMENT.

EXAMINATION STUDIES SEEK TO DETERMINE COMPLIANCE LEVELS, RETURN CHARACTERISTICS, AND THE NEED FOR A SPECIFIC COMPLIANCE PROGRAM. GENERALLY, A PROGRAM IS CONSIDERED FOR INCLUSION AS AN ACTIVE SUPPLEMENTAL SYSTEM WHEN TEST RESULTS INDICATE THERE IS A NEED TO IMPROVE COMPLIANCE IN A CERTAIN AREA OF THE LAW AND THAT AREA IS NOT ADDRESSED ADEQUATELY WITH CURRENT SELECTION SYSTEMS. THE FOLLOWING ARE A FEW EXAMPLES OF NUMEROUS SUPPLEMENTAL SELECTION SYSTEMS:

1. TAX SHELTERS.
2. TAX PROTESTERS.
3. UNALLOWABLE ITEMS.
4. INFORMATION RETURNS PROGRAM.

IN ADDITION TO THE ABOVE SUPPLEMENTAL SELECTION SYSTEMS, EXAMINATION IS ALSO INVOLVED IN NUMEROUS ACTIVITIES OR PROGRAMS DESIGNED TO ADDRESS SPECIFIC AREAS REQUIRING SPECIAL ATTENTION. EXAMPLES OF THESE ARE:

1. COORDINATED EXAMINATION PROGRAM.
2. FRAUD PROGRAM.
3. SPECIAL ENFORCEMENT PROGRAM (PRIMARILY DIRECTED AT WHITE COLLAR CRIMES, NARCOTICS CASES, ETC.).
4. TITLE 31 (BANK SECRECY ACT).

AS CAN BE SEEN, EXAMINATION'S ACTIVITY COVERS A WIDE AND VARIED AREA OF WHICH THE ENFORCEMENT OF THE BANK SECRECY ACT IS BUT ONE ASPECT.

EXAMINATION'S ROLE UNDER THE BANK SECRECY ACT

I WOULD NOW LIKE TO FOCUS ON THE BANK SECRECY ACT BY PUTTING INTO PERSPECTIVE EXAMINATION'S ROLE UNDER THE ACT AND BY OUTLINING OUR PLANS FOR USING THE CURRENCY REPORTS REQUIRED BY THE ACT.

AS YOU WELL KNOW, TREASURY HAS PRIMARY RESPONSIBILITY FOR IMPLEMENTING AND ENFORCING THE BANK SECRECY ACT. HOWEVER, RESPONSIBILITY FOR ASSISTING TREASURY IN ASSURING COMPLIANCE WITH THE REPORTING REQUIREMENTS OF THE ACT HAS BEEN DELEGATED TO A NUMBER OF FEDERAL AGENCIES. BANK SUPERVISORY AGENCIES AND THE SECURITIES AND EXCHANGE COMMISSION HAVE BEEN DELEGATED RESPONSIBILITY FOR ASSURING THAT THEIR RESPECTIVE CONSTITUENCIES COMPLY WITH THE BANK SECRECY ACT.

IN GENERAL, THE SERVICE HAS CIVIL AND CRIMINAL JURISDICTION OVER ANY FINANCIAL INSTITUTION NOT UNDER THE REGULATORY SUPERVISION OF FEDERAL BANKING AGENCIES OR THE SECURITIES AND EXCHANGE COMMISSION. THESE FUNCTIONS HAVE BEEN DIVIDED WITHIN THE SERVICE BETWEEN EXAMINATION (TO PERFORM CIVIL COMPLIANCE CHECKS) AND CRIMINAL INVESTIGATION (FOR INVESTIGATING CRIMI-

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NAL VIOLATIONS OF THE BANK SECRECY ACT). FINANCIAL INSTITUTIONS UNDER EXAMINATION'S JURISDICTION FOR BANK SECRECY ACT PURPOSES INCLUDE:

1. CURRENCY EXCHANGE OPERATIONS,
    a. FOREIGN CURRENCY EXCHANGE DEALERS;
    b. CHECK CASHING SERVICES IF SUCH SERVICES ARE THE PRIMARY BUSINESS; AND,
    c. OTHER CURRENCY EXCHANGE OPERATIONS, EXCEPT COIN DEALERS;
2. ISSUERS, REDEEMERS, OR CASHIERS OF TRAVELERS' CHECKS, MONEY ORDERS, OR SIMILAR INSTRUMENTS;
3. LICENSED ENTITIES THAT SEND OR TRANSMIT FUNDS ABROAD FOR OTHERS;
4. TELEGRAPH COMPANIES WHICH TRANSFER FUNDS DOMESTICALLY OR INTERNATIONALLY;
5. LICENSED GAMBLING CASINOS HAVING GROSS ANNUAL GAMING REVENUES IN EXCESS OF $1,000,000.
6. A DOMESTIC BRANCH, AGENT, OR AGENCY OF A FOREIGN BANK WHICH IS NOT SUPERVISED BY ONE OF THE FEDERAL BANKING AGENCIES, SUCH AS A LAW FIRM ACTING AS AN AGENT FOR A FOREIGN BANK.

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TREASURY ORDER 105-13 - NEW AUTHORITY FOR IRS

EFFECTIVE SEPTEMBER 6, 1985, THE ASSISTANT SECRETARY (ENFORCEMENT AND OPERATIONS) ISSUED TREASURY ORDER 105-13 WHICH SUBSTANTIALLY EXPANDED THE SERVICE'S AUTHORITY UNDER THE BANK SECRECY ACT.

INCLUDED IN THE NEW RESPONSIBILITIES DELEGATED TO THE SERVICE WERE:

1. AUTHORITY TO INITIATE INVESTIGATIONS OF BANKS AND BROKERS OR DEALERS IN SECURITIES FOR POSSIBLE CRIMINAL VIOLATION OF THE ACT.
2. AUTHORITY TO GRANT EXEMPTIONS FROM THE REPORTING REQUIREMENTS CONTAINED IN THE ACT.
3. AUTHORITY TO ISSUE REQUESTS FOR LISTS OF FINANCIAL INSTITUTION CUSTOMERS WHOSE CURRENCY TRANSACTIONS HAVE BEEN EXEMPTED FROM THE REPORTING REQUIREMENTS OF THE ACT.
4. AUTHORITY TO DIRECT BANKS TO FILE CURRENCY TRANSACTION REPORTS AS PRESCRIBED IN THE ACT WITH RESPECT TO CUSTOMERS WHOSE TRANSACTIONS HAD PREVIOUSLY BEEN EXEMPTED.
5. RESPONSIBILITY TC ASSURE COMPLIANCE WITH THE REQUIREMENTS OF THE ACT BY ALL BANKS NOT CURRENTLY

EXAMINED BY FEDERAL BANK SUPERVISORY AGENCIES FOR SAFETY AND SOUNDNESS (i.e., STATE CHARTERED SAVINGS AND LOAN ASSOCIATIONS, CREDIT UNIONS, ETC.).

THIS TREASURY ORDER HAS BEEN REDELEGATED, BY THE COMMISSIONER, TO THE APPROPRIATE FUNCTIONAL LEVELS. EXAMINATION HAS RESPONSIBILITY FOR ENFORCEMENT OF THE CIVIL ASPECTS OF THE EXEMPTION PROVISIONS OF THE BANK SECRECY ACT. IN ADDITION, EXAMINATION HAS RESPONSIBILITY FOR ASSURING COMPLIANCE WITH THE FILING OF CTRs FOR THOSE BANKS NOT CURRENTLY EXAMINED BY FEDERAL BANK SUPERVISORY AGENCIES.

THE CRIMINAL INVESTIGATION FUNCTION NOW HAS THE AUTHORITY TO INITIATE CRIMINAL INVESTIGATIONS OF ALL TITLE 31 FINANCIAL INSTITUTIONS. THIS COVERS ALL BANKS, INCLUDING INSURED BANKS, WHICH ARE UNDER THE REGULATORY SUPERVISION OF FEDERAL BANKING AGENCIES, AS WELL AS BROKERS OR DEALERS IN SECURITIES WHO ARE REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION.

THE AUTHORITY FOR REVIEWING EXEMPTION REQUESTS, GRANTING SPECIAL EXEMPTIONS, AND DIRECTING BANKS TO FILE THE CURRENCY TRANSACTION REPORTS, WHERE NONE HAD BEEN PREVIOUSLY FILED, HAS BEEN DELEGATED TO THE DIRECTOR, DETROIT DATA CENTER, WHICH IS UNDER THE ASSISTANT COMMISSIONER (PLANNING, FINANCE AND RESEARCH). ALTHOUGH THIS SPECIFIC AUTHORITY HAS NOT BEEN DELEGATED TO EXAMINATION, WE HAVE BEEN CLOSELY INVOLVED, TOGETHER WITH CRIMINAL INVESTIGATION, IN THE ESTABLISHMENT OF A NEW UNIT AT THE DETROIT DATA CENTER (COMPLIANCE REVIEW GROUP), DESIGNED TO MEET THE NEW RESPONSIBILITY OF PERFORMING DETERMINATIONS AND EXECUTING REQUESTS FOR BANK EXEMPT LISTS AS WELL AS HANDLING INQUIRIES. TOGETHER WITH CRIMINAL INVESTIGATION, WE WILL BE FUNCTIONALLY RESPONSIBLE FOR INSURING THAT THIS NEW UNIT PROPERLY CARRIES OUT ITS RESPONSIBILITIES. EXAMINATION AND CRIMINAL INVESTIGATION HAVE SCHEDULED EXTENSIVE TRAINING SESSIONS FOR THE MEMBERS OF THIS NEW UNIT. IT IS ANTICIPATED THAT THIS UNIT WILL BE FULLY OPERATIONAL WITHIN THE NEXT THREE WEEKS.

IN ORDER FOR EXAMINATION TO UTILIZE THE INFORMATION AVAILABLE AS A RESULT OF TREASURY ORDER 105-13, WE HAVE ESTABLISHED A NEW NATIONAL OFFICE POSITION AT THE DETROIT DATA CENTER. THIS POSIITION WILL COORDINATE QUESTIONABLE EXEMPTION TRENDS, LEADS, ENFORCEMENT NEEDS, AND CONCERNS THAT MIGHT DEVELOP FROM UTILIZATION OF THE NEW EXEMPTION AUTHORITY. IN ADDITION, THE DETROIT DATA CENTER IS SECURING BANK EXEMPT LISTS WHICH FIELD EXAMINATION PERSONNEL WILL SCREEN FOR POSSIBLE USE IN IDENTIFYING TAXPAYERS WITH UNREPORTED INCOME.

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EXAMINATION'S PLANS FOR UTILIZING CTRs

NOW, I WOULD LIKE TO COMMENT ON HOW EXAMINATION PLANS TO UTILIZE THE CURRENCY REPORTS REQUIRED BY THE ACT. THE PERFORMANCE OF COMPLIANCE CHECKS ON FINANCIAL INSTITUTIONS IS NECESSARY TO ENSURE INTEGRITY WITH THE FILING REQUIREMENTS. HOWEVER, THE REAL BENEFITS TO BE DERIVED FROM CTR INFORMATION WILL BE THEIR USE IN IDENTIFYING THOSE RETURNS TRULY IN NEED OF EXAMINATION. THEREFORE, EXAMINATION IS STUDYING HOW BEST TO UTILIZE THE CURRENCY REPORTS REQUIRED BY THE BANK SECRECY ACT. WE MUST BE ABLE TO DISCRIMINATE AMONG THE LARGE VOLUME OF THESE REPORTS TO IDENTIFY THOSE WITH INDICATIONS OF POTENTIAL NON-COMPLIANCE.

BEFORE I DESCRIBE SOME OF THESE STUDIES, LET ME SAY THAT IT IS DIFFICULT TO USE CTRs AS THE SOLE INDICATION OF NON-COMPLIANCE. OUR RESEARCH EFFORTS IN THIS AREA HAVE TAKEN A NOVEL APPROACH TO BUILDING A SUPPLEMENTAL SELECTION SYSTEM. TRADITIONALLY, WE HAVE APPROACHED THE BUILDING OF A SUPPLEMENTAL SELECTION SYSTEM USING DATA APPEARING ON A FILED TAX RETURN. THE STUDIES WHICH I AM ABOUT TO DESCRIBE FOCUS PRIMARILY ON INFORMATION NOT APPEARING ON A FILED RETURN WITH CTR INFORMATION AS ONE COMPONENT.

THE FLORIDA TAX HAVEN STUDY IS ATTEMPTING TO ESTABLISH A PROFILE OF INDIVIDUALS INVOLVED IN MONEY LAUNDERING SO THAT WE CAN THEN BUILD THIS PROFILE INTO A SUPPLEMENTAL SELECTION SYSTEM. DATA FOR THIS STUDY IS BEING DRAWN FROM A CASE IN SOUTH FLORIDA INVOLVING A MAJOR MONEY LAUNDERING SCHEME. THE CASE INVOLVES A FLORIDA TAX PREPARER ARRESTED FOR VARIOUS CURRENCY AND NARCOTICS VIOLATIONS. AS A RESULT OF THAT ARREST, A LARGE VOLUME OF CLIENT FILES AND RELATED INFORMATION REGARDING APPROXIMATELY 800 TAXPAYERS WAS ACQUIRED BY THE INTERNAL REVENUE SERVICE. THESE RECORDS, WHICH INCLUDE OVER 200,000 DOCUMENTS, WERE MICROFILMED AND REASSEMBLED INTO AN ORGANIZED AND SEARCHABLE FORMAT. IT APPEARS THAT THIS PREPARER, EITHER ACTING AS PRINCIPAL OR AGENT FOR OTHER PARTIES, ESTABLISHED A NUMBER OF BANK ACCOUNTS IN A LOCAL AREA SAVINGS AND LOAN INSTITUTION WITH WORLDWIDE HEADQUARTERS.

A PRELIMINARY RECONSTRUCTION OF INCOME, USING CURRENCY MONETARY INSTRUMENT REPORTS (CMIR), FILED BY THIS PREPARER, INDICATES THAT MORE THAN $38 MILLION WAS LAUNDERED BACK INTO SOUTH FLORIDA DURING 1982 AND THE FIRST 5 MONTHS OF 1983. EXAMINATIONS, TO DATE, INDICATE THAT TWO BASIC MONEY LAUNDERING SCHEMES WERE UTILIZED. ONE OF THE METHODS USED INVOLVED THE PHYSICAL DELIVERY OF CASH TO THE LOCAL AGENCY OF A FOREIGN BANK FOR THE PURPOSE OF WIRING THESE FUNDS TO A FOREIGN

COUNTRY. WIRING FUNDS, HOWEVER, ESTABLISHED A PAPER TRAIL DUE TO BANK SECRECY ACT REPORTING REQUIREMENTS. THEREFORE, TO CIRCUMVENT THIS, IN THE MAJORITY OF CASES, THE PREPARER PERSONALLY TRANSPORTED THE CASH, VIA CHARTERED PLANE, TO A TAX HAVEN COUNTRY.

DATA WAS COLLECTED FROM THE EXAMINATIONS OF THOSE CLIENTS WHO HAD FAILED TO REPORT PART OR ALL OF THEIR INCOME. OF ABOUT 135 CASES COMPLETED SO FAR, EXAMINERS HAVE DISCOVERED MORE THAN $49.5 MILLION IN UNREPORTED INCOME AND APPROXIMATELY $37 MILLION HAS BEEN PROPOSED IN ADDITIONAL TAX AND PENALTIES. CTRs WERE USED IN CONJUNCTION WITH OTHER SOURCES OF INFORMATION SUCH AS CMIRs, BANK RECORDS, ETC., TO UNCOVER ABOUT $16 MILLION OF THE UNREPORTED INCOME. HOWEVER, CASH AMOUNTS SHOWN ON THE CTRs THEMSELVES TOTALED LESS THAN $500,000. THE FLORIDA TAX HAVEN STUDY INDICATED THAT CTRs ARE A VALUABLE TOOL WHEN USED WITH OTHER INFORMATION SOURCES. THE CTR ALONE CANNOT IDENTIFY AN UNDER-REPORTER AND THE AMOUNT OF UNREPORTED INCOME.

WE ARE NOW ATTEMPTING TO USE THE DATA FROM THE FLORIDA TAX HAVEN STUDY TO IDENTIFY INDIVIDUALS WHO POSSESS THE SAME CHARACTERISTICS AS THOSE WHO WERE FOUND TO BE CONCEALING INCOME IN THE FLORIDA CASE. THIS WOULD GIVE THE SERVICE AN ADDITIONAL SELECTION SYSTEM FOR IDENTIFYING RETURNS IN NEED OF EXAMINATION.

IN ADDITION, A TAX HAVEN OFFSHORE BANKING PROJECT HAS BEEN ESTABLISHED JOINTLY BY EXAMINATION AND CRIMINAL INVESTIGATION TO CONSOLIDATE THE VARIOUS TYPES OF THIRD PARTY INFORMATION WHICH IS ASSOCIATED WITH TAX HAVEN ACTIVITY.

DATA FROM THIS PROJECT WILL BE USED TO SELECT SOME CASES FOR A CONTROLLED STUDY WHICH WILL EVALUATE AND COMBINE INFORMATION FROM THIRD PARTY SOURCES, INCLUDING CTRs, TO TEST THE EFFECTIVENESS OF THIS TECHNIQUE IN IDENTIFYING NON-COMPLIANCE. OTHER CASES WILL BE REFERRED TO THE FIELD AS A RESULT OF CIVIL LEADS PROVIDED TO EXAMINATION, BY CRIMINAL INVESTIGATION, FROM THIS PROJECT. THESE LEADS WILL BE TRACKED AND RESULTS ANALYZED TO DETECT COMMON PATTERNS OF MONEY LAUNDERING TECHNIQUES.

THESE EFFORTS ARE STILL ONGOING, AND IT IS NOT CERTAIN HOW USEFUL THEY WE WILL BE.

CONCLUSION

FINALLY, I WOULD LIKE TO POINT OUT AN INCONSISTENCY BETWEEN THE SUMMONS AUTHORITY PRESENTLY AVAILABLE UNDER TITLE 26 AND TITLE 31 WHICH DOES HAVE AN IMPACT ON OUR ABILITY TO ENFORCE TITLE 31. PRESENTLY, WE CANNOT HONOR A FINANCIAL INSTITUTION'S REQUEST FOR A SUMMONS IN CONNECTION WITH A COMPLIANCE CHECK, NOR CAN WE SUMMONS OR SUBPOENA RECORDS FROM AN INSTITUTION

THAT REFUSES TO COOPERATE. COOPERATING FINANCIAL INSTITUTIONS REQUEST A SUMMONS AS A MEANS OF PROTECTING THEMSELVES FROM POSSIBLE SUIT BY CLIENTS. THIS HAPPENS FREQUENTLY IN TITLE 26 EXAMINATIONS AND WE ISSUE SUCH A SUMMONS TO THE REQUESTING BANK. WITHOUT SUCH AUTHORITY UNDER TITLE 31, INSTITUTIONS WHO REALLY WANT TO COOPERATE WITH THE IRS REFUSE TO DO SO FOR THEIR OWN LEGAL PROTECTION. FURTHERMORE, IF WE ARE CONDUCTING A TITLE 31 EXAMINATION AND A FINANCIAL INSTITUTION REFUSES TO PROVIDE US WITH APPROPRIATE BOOKS AND RECORDS TO DETERMINE IF THEY HAVE COMPLIED WITH THE ACT, WE HAVE TO STOP OUR EXAMINATION AND FORWARD AN INCOMPLETE CASE TO TREASURY FOR APPROPRIATE ACTION. THIS IS WASTEFUL OF OUR RESOURCES AND IS NOT ADMINISTRATIVELY EFFECTIVE.

IN SUMMARY, I HAVE OUTLINED THE MISSION OF EXAMINATION AND GIVEN A GENERAL IDEA AS TO THE WIDE RANGE OF ACTIVITIES IN WHICH EXAMINATION IS INVOLVED. I HAVE ALSO TRIED TO PROVIDE A PERSPECTIVE OF EXAMINATION'S ROLE RELATIVE TO THE FRAMEWORK OF THE MULTI-AGENCY RESPONSIBILITIES FOR THIS ACT. I HOPE I HAVE ALSO EMPHASIZED THE IMPORTANCE OF OUR EFFORTS TO DEVELOP A SUPPLEMENTAL SELECTION SYSTEM USING CURRENCY REPORTS REQUIRED BY THE BANK SECRECY ACT AS AN INTEGRAL PART OF OUR EFFORTS TO IMPROVE VOLUNTARY COMPLIANCE.

AGAIN, I WOULD LIKE TO THANK THIS COMMITTEE FOR ALLOWING ME TO PROVIDE THIS INFORMATION.

STATEMENT OF
FRANCIS M. PASSARELLI, ACTING DIRECTOR
OFFICE OF EXAMINATIONS AND SUPERVISION
FEDERAL HOME LOAN BANK BOARD

BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U. S. HOUSE OF REPRESENTATIVES
APRIL 17, 1986

Mr. Chairman and distinguished members of the Subcommittee, I am Francis M. Passarelli, Acting Director of the Office of Examinations and Supervision of the Federal Home Loan Bank Board.

Accompanying me today is Harry W. Quillian, Acting General Counsel of the Board, and Rosemary Stewart, Director of the Board's Office of Enforcement.

We are here today to testify on the Board's efforts to carry out its responsibilities under the Bank Secrecy Act. The Board recognizes the importance of vigorous enforcement of the Bank Secrecy Act and has been reviewing its activities in this area to explore steps to strengthen implementation of the Act.

In my testimony, I will talk briefly about the Board and the Office of Examinations and Supervision. Then I will provide information about our examination process in general, our Bank Secrecy Act procedures, the way the Board has carried out its responsibilities under the Bank Secrecy Act, and our plans for continuing to strengthen our Bank Secrecy Act activities. I will then address issues the Subcommittee raised with regard to other legislation and proposed legislation that have implications for the effort to combat money laundering.

The Federal Home Loan Bank Board

The Federal Home Loan Bank Board is an independent agency of the Federal government. It is the regulatory agency for all federally chartered thrift institutions and is responsible for the enforcement of the Federal Home Loan Bank Act of 1932, the Home Owners' Loan Act of 1933, and the National Housing Act of 1934. It shares with the states regulatory authority over state-chartered thrifts whose deposits are insured by the Federal Savings and Loan Insurance Corporation (FSLIC).

Examinations and Supervision

The Office of Examinations and Supervision (OES) provides direction and oversight for carrying out the Board's responsibility for examination and supervision of all institutions chartered by the Federal Home Loan Bank Board or insured by the Federal Savings and Loan Insurance Corporation. Under the guidance of OES, Bank System examiners determine the financial safety and soundness of insured institutions, check for regulatory compliance, and identify institutions that present an increased risk of loss to the FSLIC.

Examinations are the heart of the process by which the Board carries out its responsibilities to regulate the thrift industry. An examination is designed primarily to evaluate the safety and soundness of a thrift institution. The examination reviews not only financial matters, but also management capabilities and performance.

The supervisory process is based on examination findings. When an examination reveals violations of statutes, regulations, or agreements between the institution and the regulator, the supervisory process is implemented to correct the problem through cooperative efforts with the institution or, in the absence of cooperation, through formal enforcement proceedings.

The process of examining and supervising thrift institutions is exacting, time consuming, and difficult, because of the increasingly complex array of assets and liabilities held by thrift institutions. For example, in 1975, the typical thrift had as liabilities, passbook accounts, time deposits and certificates of deposit. Its assets were principally residential mortgage loans secured by first liens. Today, liabilities can include reverse repurchase agreements (reverse REPOs),"equity participation" certificates of deposit, convertible subordinated debt, money market deposit accounts, and a variety of other accounts. Assets are similarly complex including mortgage pass-through securities such as Collateralized Mortgage Obligations (CMOs). In some states, state-chartered thrifts have virtually unlimited investment authority, and have, in fact, invested in assets ranging from windmill farms, racehorses, and fast-food restaurants to wildcat oil exploration and noninvestment grade ("junk") bonds. Asset/liability management employs such tools as hedging instruments and interest rate swaps.

Not only must examination and supervision deal with complex asset/liability structures at thrift institutions, they must also handle a thrift industry still experiencing great stress. The deposits of FSLIC-insured thrift institutions grew from $278 billion in 1975 to $847 billion at the beginning of 1986. However, net worth of insured institutions has not kept pace with the growth in deposits. More than 1500 institutions have disappeared through consolidation and merger since 1975. Moreover, from 1981 through 1985, the FSLIC liquidated 27 institutions, more than double the 13 institutions liquidated during the prior 47 years of the FSLIC. These difficulties have taxed our examination and supervisory capabilities.

In addition, Congress in recent years has added to the responsibilities of the Board, and consequently to the work of our examination and supervisory personnel, the detection of violations of laws which have goals other than the maintenance of financial health of the institutions we examine. For example, examination procedures provide for checking for compliance with the requirement that lenders provide home buyers with advance disclosure of real estate costs (the Real Estate Settlement Procedures Act). Examination procedures call for checking the accuracy of complex disclosures to borrowers with regard to the annual percentage rates of their loans (the Truth In Lending Act). Examiners must check for compliance with statutes that prohibit lenders from discriminating against borrowers because of their race, religion, or sex (the Fair Housing Act and the Equal Credit Opportunity Act). And they must examine for the protection of the rights of customers who use automated teller machines (the Electronic Fund Transfer Act). Further, examiners must check for compliance with the Fair Credit Billing Act, the Fair Debt Collection Act, and the Community Reinvestment Act. In fact, in addition to the basic legislation establishing the Board and its responsibilities, at least 15 statutes give examination and/or enforcement responsibilities to the Board.

The Bank Secrecy Act

The Bank Secrecy Act (BSA), which is designed to detect and deter activities of money launderers serving white collar and organized crime, is addressed in Board examinations. The Treasury Department has primary responsibility for enforcement of the Act, but its regulations, called the Financial Recordkeeping and Reporting Regulations (31 C.F.R. Part 103), delegate to the Board and other Federal financial regulatory agencies the responsibility for assuring compliance by the institutions they regulate. Thus, Treasury has delegated to the Bank Board responsibility for assuring compliance by institutions whose accounts are FSLIC-insured. We have carried out this responsibility in part by having our examiners include in their regular examinations a review of institutions' compliance with the Bank Secrecy Act.

The Board's Bank Secrecy Act examination procedures were developed in conjunction with the Office of Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation and in consultation with the Treasury Department and the Government Accounting Office. These Examination Objectives and Procedures (EOP) are designed to test institutions' compliance with the BSA regulations and are divided into minimum scope and expanded scope procedures. In order to focus our limited examination resources on the most urgent, targeted areas, the EOP's mandatory usage was suspended in 1982, but the EOP, Examiner Worksheets, and Bank Secrecy Act check list remained the principal guidance to field examiners with regard to full scale compliance examinations and the Bank Secrecy Act, and examiners continued to be responsible for meeting examination objectives.

Whenever necessary, examiners have the responsibility to apprise institution management, particularly of newly chartered or insured institutions, of its responsibilities under the BSA regulations. The Board's Supervisory Agents at the twelve Federal Home Loan Banks have the responsibility to take appropriate supervisory action necessary to obtain institution compliance with these requirements.

Substantive violations that appear to warrant civil or criminal penalties are referred to the Treasury Department as soon as they are discovered by Bank System examiners. In addition, summary reports of all violations observed by our examiners are transmitted twice a year to the Treasury Department. Included in the Board's report to the Treasury is the identity of the institution where a violation occurred, a description of the violation and corrective action promised or already taken by the institution.

The BSA statute and regulations authorize the Treasury Department to assess a savings institution and any partner, director, officer, or employee thereof a civil penalty for any violation of the BSA. The statute and regulations also provide for imposition of a criminal penalty by the United States District Courts. OES may recommend to the Treasury Department imposition of civil penalties and may make referrals for possible criminal investigation regarding suspected BSA violations.

In 1985, 1,808 thrift institutions were examined. In 10 of those institutions, examiners found 46 violations of the Bank Secrecy Act. Forty of those violations concerned failure to file currency transaction reports; the remaining six concerned failure to maintain a list of exempt customers. In all cases, we required corrective action, such as directing that Currency Transaction reports be filed and obtaining assurances from management that the violations and the practices that led to them would be corrected. In one instance, we referred the matter to Treasury with the recommendation that a civil penalty be assessed and a criminal investigation be undertaken.

We hope that the small number of violations we detected in our examination process in 1985 reflects that most institutions we regulate are in compliance with the Bank Secrecy Act. Further, we have recently received the General Accounting Office's draft report of its audit of the way our examiners have carried out our Bank Secrecy Act examination procedures, and will be reviewing that report and its recommendations very carefully. Moreover, we have taken a number of actions to strengthen our examination and supervisory processes in general and with regard to the Bank Secrecy Act in particular, and we are actively in the process of taking a number of other actions that we believe are needed. I would like to share those with you today.

The Bank Board recognized that our examination staff was too small to handle the increased demands imposed by a more complicated thrift environment under deregulation and by the need to review and enforce a multitude of statutory and regulatory requirements, including those of the Bank Secrecy Act. Therefore, the Bank Board, on July 6, 1985, transferred the Board's 747 examiners from the Federal civil service system to the employ of the 12 District Banks. At the same time, the Bank Board delegated responsibility for conducting examinations to the District Banks, under policies and procedures established by the Board.

With this reorganization, the examiners and the District Banks' Supervisory Agents became part of the same organizational structure, providing closer coordination and faster response to early warning signals of an institution's financial problems.

Removing the examiners from the civil service system permitted hiring more examiners, raising examiners' salaries, and increasing their benefits. By making compensation competitive, the Board took an important step to reduce the rapid turnover among examiners, and thus ensure that the Bank System would have more and better qualified examiners to meet the increased demands. By December 31, 1985, the Federal Home Loan Banks had increased their examination staffs to 1,003, a more than one-third increase over the July 6, 1985, figure.

Subsequent to the field reorganization, the Federal Home Loan Banks, at the Chairman's direction, have also increased the size of their supervisory staffs and increased the number of other professional staff members who assist in carrying out the authorities the Board has delegated to the Banks. The result is that the total professional staff in the Banks has increased from 1,086 in July 1985 to 1,487 at the end of March 1986. Moreover, the Chairman's goal is for this figure to reach 1,688 by June 30 1986, which will be a total growth of more than 50 percent in one year.

Strengthened Supervision

Substantial and material violations of law require immediate and firm supervisory action. To ensure that violations are corrected promptly, Chairman Gray has consistently directed Bank System staff to take aggressive supervisory action. For example, on August 9, 1985, the Chairman issued a memorandum directing *inter alia* that supervisory correspondence to depository institutions be firm and precise and that there be no hesitancy to recommend formal enforcement actions where violations or unsound practices cannot be expeditiously resolved through informal supervisory efforts. On August 23, 1985, Chairman Gray issued a memorandum directing prompt and vigorous use of formal enforcement tools for material violations and deficiencies, and requiring reporting to Washington whenever such enforcement is not immediately appropriate. On February 12, 1986, the Chairman issued a memorandum directing immediate reporting of significant problems detected during examinations via the use of interim examination reports.

These directives, while applying to violations of all the laws and regulations the Board must enforce, have special meaning for strengthening our Bank Secrecy Act enforcement program. They provide clear instructions to our Supervisory Agents in resolving Bank Secrecy Act violations found in examination reports, or discovered from other sources, and make it clear that the Supervisory Agents must take prompt, effective corrective action.

Examiner Training

In its effort to carry out the enforcement of the Bank Secrecy Act, the Bank Board has been especially concerned with proper training for the examination staff in detecting violations of the Act. All new examiners are required to attend the New Examiners Training School, which includes a section on the Bank Secrecy Act as part of its curriculum. Bank Secrecy Act training includes a video tape presentation which combines a video tape we prepared with video material we purchased. It is designed for both newly hired examiners and as a refresher course for all staff members involved in examination or supervision functions relating to the Act. In addition, as part of the training session, examiners are given a copy of the Interim Report to the President and the Attorney General entitled, "The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering."

Dissemination of Information to Insured Institutions

During 1985 and thus far in 1986, we have issued a number of notices providing full information concerning the Bank Secrecy Act to institutions in the Federal Home Loan Bank System.

For example:

o Bulletin # PA-7a-3 described the responsibility of independent public accountants under the Bank Secrecy Act.

o Memorandum # T 53-7 directed the management of each institution to establish Bank Secrecy Act employee training programs, and to establish operating procedures and compliance guidelines for all employees who come into contact with currency transactions.

o Memorandum # AB-69 provided thrift institutions with an Internal Revenue Service news release on IRS' taking over responsibility for reviewing exemption lists and approving or denying individual requests for exemptions from the currency transaction reporting requirements of the Act.

o Memorandum # T 53b distributed to our institutions the amended Bank Secrecy Act regulations in their entirety, summarized their key provisions, and consolidated several earlier memoranda.

In addition, the Board also participated in the planning and production of a seminar on the Bank Secrecy Act presented to the entire banking industry at sixty locations by the National Council of Savings Institutions and the American Bankers Association.

Improved Communications With Law Enforcement Agencies

The Federal Home Loan Bank Board has worked closely with the Department of Justice, as well as the Federal banking agencies, to design and put into use a revised criminal referral form (Form 366). The revised form incorporates recommendations from the Department of Justice concerning specific information the Department needs to initiate and pursue criminal investigations. We have also developed a short version of the form to facilitate reporting less serious offenses, such as crimes that involve less than $10,000 and do not involve directors, officers, or other affiliated persons. In 1985, the Board's examiners filed 150 Forms 366 and insured institutions filed 652 forms. In the first three months of 1986, examiners filed 27 Forms 366 and the institutions themselves filed 911.

The revised Form 366 was developed jointly by members of the Attorney General's Bank Fraud Working Group, of which the Bank Board has been an active participant. The group continues to meet on a monthly basis to assure implementation of the use of the revised Form 366, and to promote further cooperation among the regulatory authorities and law enforcement agencies. As a result of the Working Group, the Bank Board and other participants have established local points of contact throughout the country so that the supervisory agency and the Justice Department can communicate quickly and directly whenever law enforcement concerns arise. In addition, the Bank Board is participating in the Justice Department's recently implemented tracking system for agency criminal referrals, and we, along with other agencies, are now providing specialized training on investigation of bank fraud that was previously available only to FBI agents.

Plans

As we look to the future, there are a number of possibilities being explored by the Bank Board to make our enforcement of the Bank Secrecy Act more efficient and effective.

One such possibility is the use of currency shipment reports that are made available by the Federal Reserve. Such reports have been of little use to our examiners, because, until recently, savings and loan associations were not permitted to use the currency services of the Federal Reserve Banks. Therefore, none of the institutions we examine and regulate were included in the reports. Now, the prohibition has been lifted, and some savings and loan associations are beginning to use the currency services of the Federal Reserve Banks. To make use of the currency shipment reports, as they pertain to institutions in the Federal Home Loan Bank System, we have incorporated in proposed new instructions for our examiners an instruction to review the reports.

In addition, this agency is currently developing a number of issuances related to the Bank Secrecy Act. Specifically:

1. We are revising our Bank Secrecy Act examination procedures:
   - o As part of a revision of our entire Examination Objectives and Procedures Manual to bring the manual up-to-date and improve its utility for examiners.
   - o To encompass all the requirements of the interagency procedures, which have recently been amended.
   - o To reflect recent recommendations from the Department of the Treasury and the Internal Revenue Service concerning the content of examination procedures.
2. We are writing Bank Secrecy Act supervisory procedures for the Supervisory Agents in the Federal Home Loan Banks; these procedures will be part of a new Supervisory Objectives and Procedures Manual currently under development.
3. We are drafting a reissuance of Bulletin #PA-7a-3 with specific guidance on audit work relative to detection and reporting of money laundering activities; the language of Bulletin #PA 7a-3 as originally issued was too broad to provide adequate guidance to independent public accountants.
4. We are also preparing several memoranda distributing recent issuances from the Department of the Treasury. These include the recently revised Currency Transaction Report, joint Treasury/Internal Revenue Service (IRS) guidelines for reviewing Currency Transaction Reports, IRS guidelines for reviewing exemptions from the currency reporting requirements, Treasury's revised definition of willful Bank Secrecy Act violations, and responses by Treasury to financial institutions' questions about the Bank Secrecy Act.

Title I (Supervisory Authority Over Depository Institutions)

The Subcommittee has asked whether there is any merit to considering giving the regulators authority to impose civil money penalties upon financial institutions for failure to report under BSA, or whether the Treasury should continue to have the authority to impose such penalties.

As you undoubtedly know, the assessment process is a lengthy one, requiring a full Administrative Procedure Act hearing if the institution or individual does not consent to payment of a proposed penalty. Therefore, it is our view that where other authorities -- Treasury, Justice, IRS --already have primary responsibility for imposing penalties under the Bank Secrecy Act, it is not necessary or desirable to duplicate this effort and authority within the financial institutions regulatory agencies.

The Subcommittee also asked to what extent the powers granted by Title I of FIRICA could be improved to support in appropriate cases criminal law enforcement investigations and to what extent, if any, the supervisory powers over depository institutions under existing law might be extended to uncover criminal activities such as tax evasion, drug trafficking, or money laundering, which could affect the safety and soundness of a financial institution.

Existing statutory authority to remove management officials is extremely exacting. In addition to proving a violation of law, rule, or regulation, or an unsafe or unsound practice, the agency must demonstrate, among other things, that the violation or unsound practice resulted in substantial financial loss to the institution or personal gain to the individual. Money laundering may be undertaken without loss of any kind to the financial institution involved, and cooperative bank officials rarely have been found to have profited personally from their involvement. If violations of BSA were added to the grounds for the institution of removal proceedings against institution officials and employees, a significant deterrent effect would surely result.

While the agencies have broad power to examine and investigate for civil purposes, it is the Justice Department and IRS that have criminal investigative authority in the identified areas. We recommend that any impediments to their conduct of such investigations be removed. We fully support the proposed amendments to the Right to Financial Privacy Act recommended by the Department of Justice to deal with one of these impediments.

TITLE XI (Right to Financial Privacy Act)

The Subcommittee also asked our views of the Right to Financial Privacy Act (RFPA). In our view, this Act creates clear impediments to criminal law enforcement efforts. This is particularly troubling when one realizes what the RFPA does not cover, while it imposes itself on one of the most necessary and sensitive areas of criminal law enforcement efforts -- the referral process.

The RFPA exempts completely each of the Federal financial institutions regulatory agencies in carrying out examination and supervisory responsibilities within our respective regulated financial institutions. By an amendment in 1982, the five regulatory agencies also may exchange information among and between one another without violating the RFPA. And the Act has never applied to transfer of information by any of the regulatory agencies to state and local law enforcement authorities.

Moreover, when an agency has information from the accounts of protected customers under the RFPA, the Act permits it to freely transfer such information to the Justice Department or other appropriate Federal law enforcement authority without prior notice to or approval from the customer. What is required is notice to the affected customer, within ten days after the transfer, that such transfer of information has occurred. This has two clearly bad effects: a customer who is involved in the suspected crime may alter records, destroy evidence, or disappear in response to the notice, and the innocent customer (such as a person who does not know that his savings accounts have been manipulated) is shocked by a nearly unintelligible notice (the exact language is mandated in the RFPA) that his records have been transferred to the Department of Justice.

The only alternative to this post-referral notice to customers is to make the referral in a very abbreviated fashion (without names or back-up documents) to avoid triggering the RFPA requirements. Justice must then issue a Grand Jury subpoena, which is exempt from the customer notice provisions of the RFPA, to obtain the detailed information it requires to properly investigate and prosecute. It is this circuitous and undesirable route that was adopted by the Attorney General's Bank Fraud Working Group with regard to Forms 366 because of the Justice Department's strong belief that customer notices were counterproductive to sound investigative and prosecutorial procedures.

"Money Laundering Bills"

The Administration's bill (H.R. 2785) contains what we believe are the necessary provisions, i.e., it would make money laundering a crime if done with intent, knowingly, or with reckless disregard for the origin of the unlawful funds. Moreover, the amendment that this bill would make to the RFPA is clearly needed to allow the flow of information required to combat crime.

The McCollum bill (H.R. 1367) is as acceptable to us as the Administration's bill. However, because it imposes a higher standard on bankers and others (who can be prosecuted if they "have knowledge or reason to know" that they are involved in the conduct of money laundering activity), we anticipate that this bill might meet with great opposition from the banking industry, just as the Bank Bribery Act (18 U.S.C. 215) has, for subjecting "ignorant but innocent" bankers to prosecution. The McCollum bill contains an amendment to the RFPA that should adequately resolve the problems with that act which we discussed earlier.

Change in Savings and Loan Control Act

The Subcommittee has expressed interest in the Bank Board's recommendations concerning possible amendments to the Change in Control Act (Control Act), particularly with respect to the criteria used to review a notice filed under the Control Act and the time period for Bank Board review and processing of a notice. In addition, the Subcommittee has requested the Bank Board's advice regarding problems it has encountered in enforcing violations of the Control Act and in eliciting information probative of a foreign national acquiror's qualifications to control an insured institution.

Acquisitions of "control" of insured institutions are governed either by the Control Act or by the Savings and Loan Holding Company Act (Holding Company Act). The Holding Company Act prohibits any "company," directly or indirectly or acting in concert with one or more other persons, through one or more subsidiaries, or one or more transactions, from acquiring control of an insured institution without the prior written approval of the Bank Board. The Control Act applies to acquisitions of control that are not subject to the Holding Company Act. It prohibits any "person," acting directly or indirectly or through or in concert with one or more persons, from acquiring control of an insured institution through a purchase, assignment, transfer, pledge or other disposition of voting stock of an insured institution unless the Bank Board has been given sixty days' prior notice pursuant to a complete Control Act Notice, and within that time period has not objected to the acquisition or extended up to another thirty days the period for objection.

Due primarily to the volume and complexity of the information submitted in Control act notices by prospective acquirors, it has been the Bank Board's experience that most, if not all, of the sixty-day statutory period is required for the Board to complete its careful review and analysis of the notices. In many cases, the Board must extend the time period for up to an additional thirty days, as permitted under the Control Act. In order to provide the Bank Board with sufficient time to review and process Control Act notices, the Board encourages the Subcommittee to consider an amendment to the Control Act to extend from sixty to ninety days the period for objection to an acquisition and to retain the current thirty-day provision for extension of the period for objection. The proposed amendment would be consistent with the Holding Company Act, which requires the Bank Board to render its decision on an acquisition within ninety days after submission of a complete application.

Both statutes employ expansive definitions of control. In the Control Act, the term connotes the power, directly or indirectly, to direct the management or policies of an insured institution. The Holding Company Act provides that the term includes control in any manner of the election of the majority of the directors of an insured institution. Control may also be found under the Holding Company Act if the Bank Board determines that a person, directly or indirectly, exercises a controlling influence over the management or policies of an insured institution. Finally, under either statute, control is conclusively determined to exist upon the acquisition of the power to vote more than 25 percent of the voting shares or securities of an insured institution. Both statutes specifically authorize the Bank Board to issue rules and regulations to carry out their purposes and prevent evasions of them. However, the Board has introduced to the Senate Committee on Banking, Housing and Urban Affairs a proposal to amend the term "control" under the Control Act to clarify the Board's authority to define by regulations that aspect of the term that connotes the power, directly or indirectly, to direct the management or policies of an insured institution.

The substantive criteria set forth in the statute to be used in considering applications under the Holding Company Act are broad and general and focus on whether the financial and managerial resources and future prospects of the acquiring company and the institution to be acquired would cause the acquisition to be detrimental to the institution or to the insurance risk of the FSLIC. In certain acquisitions involving more than one insured institution or where the acquiring company is already a savings and loan holding company, certain anticompetitive factors also must be considered. The Holding Company Act specifically prohibits the Bank Board from approving acquisitions that would have monopolistic results. Nor may the Board approve a proposed acquisition that would substantially lessen competition unless the anticompetitive effects of the transaction are clearly outweighed by a greater service to the convenience and needs of the community. Beyond the foregoing standards, however, consideration of applications under the Holding Company Act involves a significant exercise of judgment and discretion by the Bank Board.

In contrast to the Holding Company Act's approval process, the Control Act review function performed by the Bank Board is expressed in the statute in terms of a disapproval or non-disapproval of a notice filed pursuant to that Act. The Control Act provides that a proposed acquisition may be disapproved by the Bank Board on the following grounds:

1. It would result in a monopoly or be in furtherance of any combination or conspiracy to monopolize the savings and loan business in any part of the country;

2. In any section of the country it would substantially lessen competition, tend to create a monopoly, or be in restraint of trade, and the anticompetitive effects are not clearly outweighed by any benefits in the public interest;

3. The financial condition of any acquiring person is such as might jeopardize the financial stability of the institution or prejudice the interests of the depositors;

4. The competence, experience, or integrity of any acquiring person or any of the proposed management personnel indicates that it would not be in the interests of the depositors or the public to permit such person to control the institution; or

5. Any acquiring person neglects, fails, or refuses to furnish all the information required.

Through its experience in administering the Holding Company Act and Control Act, the Bank Board has encountered a variety of situations which have proved to be indicative that a potential acquiror may not meet the statutory tests. In an effort to facilitate the review process, the Board's new Acquisition of Control rules set forth certain "presumptive disqualifiers" -- types of legal proceedings or events, which, based on the Board's experience, are indicative that an acquiror may lack the qualifications to acquire control of an insured institution. These "presumptive disqualifiers" put potential acquirors on notice of the grounds upon which an application or notice may be disapproved unless adequately refuted by the acquiror.

"Presumptive disqualifiers" are divided into two types: integrity-related factors and financial factors. In the former category, for example, a prospective acquiror would be presumptively disqualified from acquiring an insured institution if during the ten-year period immediately preceding filing of the application or notice, criminal, civil or administrative judgments, consents or orders, and any indictments, formal investigations, examinations, or civil or certain administrative proceedings that terminated in any agreements, undertakings, consents or orders, were issued against, entered into by, or involved the acquiror or affiliates of the acquiror by any federal or state court, any department, agency or commission of the U.S. Government, any state or municipality, any Federal Home Loan Bank, any self-regulatory trade or professional organization, or any foreign government or governmental entity involving (a) fraud, moral turpitude, dishonesty, breach of trust or fiduciary duties, organized crime or racketeering, or (b) violation of securities or commodities laws or regulations; depository institution laws or regulations; housing authority laws or regulations; or rules, regulations, codes of conduct or ethics or a self-regulatory trade or professional organization. In addition, a prospective acquirer would be presumptively disqualified if the acquiror or affiliates of the acquiror had sought to acquire a bank or a thrift and been denied permission to do so; controlled or managed a financial institution that failed, or filed false statements with the Bank Board in connection with an application or notice. These presumptive disqualifiers shift the burden to the prospective acquiror to rebut the presumptive disqualification and provide a more manageable procedure for the Bank Board to apply in considering questionable applications.

The Subcommittee has expressed interest in the Bank Board's recommendations concerning possible modifications to the criteria used to review a notice filed under the Control Act, particularly those relating to an acquiror's qualifications to control an insured institution. In this regard, the Board encourages the Subcommittee to consider in its pursuit of possible legislation regarding thrift institutions an amendment to the Control Act to clarify the Board's authority to define further by regulation the terms "competence, experience and integrity." As discussed above, the Bank Board has set forth with specificity in its recently adopted Acquisition of Control rules conduct it believes probative of an acquiror's lack of qualifications to satisfy the statutory standards.

In addition, the Subcommittee has expressed interest in the Bank Board's procedures to elicit information which would raise significant concerns regarding a foreign national acquiror's qualifications to control an insured institution. In addition to the use of computerized background checks, liaison with other agencies to verify arrest records and other background information, and the use of targeted questions designed to elicit information concerning legal proceedings and other events which would raise substantial questions concerning an acquiror's qualifications to control an insured institution, the Board makes every feasible effort to contact the appropriate foreign law enforcement agency and, if applicable, foreign banking agency to verify a foreign national acquiror's arrest records and other background information. Although the Bank Board's experience in reviewing and processing Control Act notices and Holding Company Act applications from foreign nationals has been limited to date, it has revealed some reluctance on the part of foreign nationals to disclose information about their backgrounds and qualifications to control an insured institution but no lack of cooperation on the part of the foreign agencies to verify background information.

Finally, the Bank Board would like to take this opportunity to bring to the Subcommittee's attention a disparity between the Holding Company Act and Control Act with respect to penalties for violations of the statutes and the regulations thereunder. The Control Act only authorizes the Board to assess civil monetary penalties against any person who willfully violates the statutory provisions or regulations. Unlike the Control Act, the Holding Company Act provides for the imposition of criminal penalties against companies for willful violations and against individuals for willful violations or for aiding and abetting willful violations of the statutory provisions and regulations. In addition, the Holding Company Act authorizes the Bank Board to assess civil monetary penalties against any company that violates or any individual that aids and abets a violation of the statutory and regulatory provisions -- whether or not such violation is willful. The term "willfully" is not defined in either the Control Act or Holding Company Act, but the Board, consistent with judicial definitions of the term, generally has interpreted it as encompassing an intentional action by a person that results in a statutory or regulatory violation.

With respect to the Control Act, the Bank Board has found that the lack of a statutory definition for the term "willfully" and the absence of explicit statutory authority to assess civil monetary penalties for statutory and regulatory violations other than those committed willfully has in many cases impaired the Board's ability to enforce effectively the Control Act and the regulations thereunder. In order to eliminate uncertainty in this area and enhance the Bank Board's enforcement of the statutory and regulatory provisions, the Board requests that the Subcommittee consider amendments to the Control Act to clarify the Board's authority to define by regulation. In addition, the Bank Board recommends that the Subcommittee's consideration of amendments to Control Act in this regard include clarification that private rights of action exist under the Control Act and that the Board may seek equitable relief for statutory and regulatory violations, and a description of the procedures to be followed by the Board in assessing civil monetary penalties.

I hope that the comments I have provided the Subcommittee will be helpful as the Subcommittee considers possible changes to the Financial Institutions Regulatory and Interest Rate Control Act of 1978 and the "money laundering" bills that have been proposed.

STATEMENT ON

BANK SECRECY ACT ENFORCEMENT, MONEY LAUNDERING AND CRIMINAL ACTIVITY IN INSURED FINANCIAL INSTITUTIONS

PRESENTED TO

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,
REGULATION AND INSURANCE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

BY

JAMES R. DUDINE
CHIEF, SPECIAL ACTIVITIES SECTION
DIVISION OF BANK SUPERVISION
FEDERAL DEPOSIT INSURANCE CORPORATION

Room 2128, Rayburn House Office Building

April 17, 1986
9:30 a.m.

Mr. Chairman, I am pleased to be here this morning on behalf of the Federal Deposit Insurance Corporation (FDIC) to report on the FDIC's enforcement of the Bank Secrecy Act and to discuss, from the FDIC's perspective, the steps we have taken and our thoughts on what still could be done to address the problems the criminal element poses to this country's financial institutions.

We have provided the Committee with a comprehensive report on our efforts to improve compliance with the Bank Secrecy Act. That report reveals we are finding more violations in the banks we examine. The trend in violations is up partly because of FDIC's strategy to focus examination resources on problem banks. In the past three years, problem banks and banks targeted specifically for potential Bank Secrecy Act problems made up a greater proportion of examinations. Such banks would be expected to exhibit a higher incidence of violations than a cross-section of the banking population. The great majority of the violations on which the statistics in our report are based represent inadvertent failures to follow bank procedures and incomplete or late CTR filings rather than actual failures to file CTRs.

Nevertheless, we are not satisfied with the level of compliance by the banks we supervise and we are continually improving our enforcement efforts. Since this Committee held hearings last

April, the following steps have been taken:

First, the interagency examination procedures have been revised and are awaiting Treasury's approval. They have been improved in the areas of international transactions and wire transfers and now cover peripheral bank services such as trust departments and dealer departments. Examiners will be required to follow a stricter regimen, look closely at exemptions granted to customers, and document their activities at various points during the examination.

We have completely revised our educational program for examiners who conduct Bank Secrecy Act compliance examinations. The new program supplements our fundamental examiner training series and on-the-job training. It is delivered at regular intervals in Washington, and regional presentations have been added to reach a larger number of examiners. The program includes information on the latest money laundering methods and instruction on recognizing possible money laundering schemes.

We are working more closely with Treasury and IRS to improve the flow of information and to assist each other in carrying out our responsibilities under the Bank Secrecy Act. The Working Group concept has proved to be successful in improving our response to bank fraud and insider crimes. We hope to make similar progress with this concept in the Bank Secrecy Act area.

We are making more and better use of external targeting of institutions for Bank Secrecy Act reviews. The Customs Service's analysis of currency flows and cash shipments of individual banks and bank-to-peer group relationships provides regulators with an intelligent way to select banks for examination. We strongly support the work being done in this area.

Because the safety and soundness of insured banks is of utmost importance to the FDIC, the resources we can allocate to Bank Secrecy Act compliance are limited. Thus, the method of selecting banks to be examined is very critical to our overall enforcement effort. In addition to targeting banks based on information from the Treasury Department, IRS or the Customs Service, the idea of examining a random sample of banks each year is being considered.

FDIC usually conducts Bank Secrecy Act examinations in conjunction with its review for consumer compliance. We have recently begun reviewing Bank Secrecy Act regulations at safety and soundness examinations or conducting an independent examination, as circumstances warrant. This approach adds flexibility to our enforcement program and permits us to respond quickly to potential problems.

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As we have stated in the past, bank supervision and examination procedures cannot assure day-to-day compliance with currency reporting requirements. Financial institutions must install internal controls and systems. They must also train and re-train their employees and audit for compliance. Even under the best of conditions, employees can be corrupted into circumventing the controls and violating the laws.

During the past fifteen months, we have given a lot of attention to improving our efforts to deal with the criminal conduct of bank insiders. We are very encouraged by the progress being made by the Bank Fraud Working Group. The Group was organized under the interagency agreement signed in April 1985 to improve cooperation between bank regulators and law enforcement agencies in responding to the criminal threat to insured financial institutions. Similar progress in dealing with the criminal aspects of money laundering is possible under the current legal environment. However, the government's response to the problem would be strengthened by making money laundering a federal crime. H.R. 2785 and other bills address this fundamental weakness and would permit prosecutors to attack organized criminals directly--by making money laundering the crime--rather than having to build their cases on failures to file currency reports. We support a federal crime of money laundering and generally agree with the higher penalties and stiffer sentences contained in H.R. 2785.

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H.R. 2785 contains much needed amendments to the Right to Financial Privacy Act of 1978. There is no question that the Right to Financial Privacy Act serves as a legal and psychological barrier to the flow of information from financial institutions and their regulators to federal law enforcement agencies. Unimpeded information flows are essential to the successful investigation and prosecution of financial criminals and money launderers. This dysfunctional impact appears to reach well beyond the legitimate privacy concerns that Congress intended to protect.

As we have pointed out before, the Act, as interpreted by most interested parties, extends the customer-privacy protections to bank insiders who are often also customers of the bank. Insider abuse of federally insured financial institutions is unquestionably a major cause of bank failures and of losses to the FDIC's insurance fund. We believe that insiders, by virtue of their position in federally insured institutions, ought to be treated differently than a bank's "arms-length" customers.

The amendments to the Right to Financial Privacy Act contained in H.R. 2785 would correct this and other flaws, while preserving the privacy interests of law abiding bank customers. Moreover, financial institutions would be freed from the restrictions and uncertainties now affecting their ability to make informative criminal referrals.

In conclusion, I am convinced that we are making progress in our efforts to deal with criminal conduct in the banking industry, despite the strain placed on our resources by unprecedented bank failures and by budgetary considerations. The commitment by the Department of Justice evidenced in the signing of the interagency agreement and the efforts, to date, of the Bank Fraud Working Group are important examples of the type of progress that can be achieved by working together. This approach should work equally well for the agencies charged with the responsibility to enforce the Bank Secrecy Act.

Thank you.

EMBARGOED UNTIL DELIVERY

STATEMENT OF ROBERT B. SERINO
DEPUTY CHIEF COUNSEL (OPERATIONS)
OFFICE OF THE COMPTROLLER OF THE CURRENCY
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES
April 17, 1986

Mr. Chairman and members of the Subcommittee:
Thank you for the opportunity to bring you up to date on the Office of the Comptroller of the Currency's (OCC) activities in the Bank Secrecy Act (BSA) area and to express our views on the legislative changes needed to facilitate our efforts to assist the law enforcement community in its criminal enforcement efforts. As supervisors of the national banking system, we share this Subcommittee's concern that our nation's financial institutions not be used wittingly or unwittingly to facilitate or conceal criminal activity. We recognize the importance of

our role in assisting the law enforcement community and have worked actively to support their efforts. While we believe that we have made substantial progress in the past year, we recognize that much remains to be done.

The progress report which we provided to you earlier this week in response to specific questions posed in your letter of March 27, 1986, outlines our accomplishments in detail. In addition to questions regarding our progress, you also asked for our thoughts with respect to certain issues under the various provisions of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 and for our analyses and comments on various money laundering bills now before the House. We have addressed these questions in detail in an attachment to this statement. I will not repeat what we have written, but I would like today to highlight for you certain key points.

First, we have improved our management control over the agency's BSA program. We have, for instance, established in the Chief National Bank Examiner's (CNBE) office a central clearinghouse for BSA operations. The Enforcement and Compliance Division of the OCC has been coordinating activities and giving legal guidance. In the Districts, we have established focal points for BSA activities. Bank secrecy specialists and District Counsel are charged with additional responsibilities. These changes have ensured a continuing focus on BSA issues, a reliable flow of information on BSA matters, and a sound operating structure for BSA compliance activities. This new structure and the people involved have contributed substantially to our progress over the last year.

Second, we have intensified BSA training of our examiners. During the past year alone over half of our examiners received training in BSA matters. This training was put together by our BSA specialists and was presented at District staff training conferences. It was also given in OCC's White-Collar Crime course, which was presented four times in 1985, and in the Associate National Bank Examiner School for Advanced Study. On-the-job BSA training activities also have reached many of our other examiners. For instance, the new hires and junior assistant bank examiners training program provides for them to participate in a BSA compliance examination as part of their training. In addition, training profiles now reflect an examiner's knowledge of the BSA and OCC's examination procedures, permitting us to target needed training.

Third, we have sought not only to train our examiners, but also to increase awareness within the industry. As part of our efforts in this area, we worked with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board (FRB) to develop a training segment for the American Bankers Association's one day video conference, which was repeated in

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61 locations during late 1985 and reached nearly 6,000 people. In addition, we have provided speakers to participate in meetings before banking and law enforcement community groups to discuss BSA and other enforcement issues. Moreover, our BSA specialists and attorneys across the country and here in Washington respond to inquiries on a daily basis.

Fourth, we have participated in various interagency task forces and working groups and have continued to assist the law enforcement community whenever possible in their enforcement efforts. We were, for instance, instrumental in establishing a working group consisting of senior officials from our office, the Justice Department's Criminal Division, the FBI, and each of the major financial institutions regulatory agencies. The group's purpose was to improve the Federal Government's effectiveness in fighting crime in the nation's financial institutions.

The group made significant progress during 1985 and continues to operate effectively. Chief among its achievements were a variety of improvements in communications between and among the financial institutions regulators and the law enforcement community. A standard criminal referral form was designed and implemented for use by each of the supervisory agencies and all financial institutions. The form has promoted consistency in the reporting of suspected criminal offenses and has provided

Justice with a better means of tracking criminal referrals. Agreement was reached that the regulatory agencies would each adopt regulations or guidelines similar to OCC's Interpretive Ruling (12 C.F.R. § 7.5225), which requires banks to report any suspected criminal activity. We have also proposed amendments to improve our rule.

In addition, the group improved communications by identifying points of contact in each agency on the national and local level, thus establishing a network of individuals responsible for coordinating referrals and prosecutions. Specifically at OCC, District Counsel have been required to establish and maintain contact with individual United States Attorneys' Offices, FBI offices and strike forces for the purpose of coordinating criminal enforcement matters.

Moreover, to accelerate our response to law enforcement inquiries, we have formally delegated additional authority to the District Offices to respond and provide information directly. Similarly, we have worked with trade groups and individual representatives of the banking community to establish banking community contacts for the swift handling of problems in this area.

OCC also has enhanced its Enforcement and Compliance Information System (ECIS) to track criminal referrals and improve communications. This system generates reports that are distributed by OCC's District Counsel to U.S. Attorneys for feedback on the status of referrals. The ECIS was recently expanded to include the most significant criminal referrals made by the other regulatory agencies and records of disciplinary actions taken by the OCC or the other agencies against bank officials. As a result, we are now able to use the system in our background investigations of organizers of new banks and of change in control applicants.

The working group also recommended that a joint training course be developed to cross train FBI agents and examiners. The agencies and the Department of Justice each committed resources, and a formal training course was developed. A series of joint training sessions has since been held both at the FBI Academy at Quantico and at selected sites around the country.

In addition to our work with the Department of Justice working group, OCC participated actively in efforts specifically focused on improving BSA enforcement. We worked with Treasury and other financial institutions regulators to revise the uniform BSA examination procedures. These revisions, which are presently undergoing a final review at Treasury, should be implemented in the near future.

We also vigorously supported the work of the IRS/Financial Institutions Regulatory Working Group which was created in December 1985 after the IRS was delegated additional responsibilities under BSA. This group will play an important role in facilitating communications among the agencies with BSA enforcement and compliance responsibilities, and in providing a vehicle for resolving problems. We have also developed a set of uniform guidelines and procedures for handling BSA referrals which will create a consistent method of dealing with identified violations.

THE FUTURE

Despite this progress, we believe that we must continue to do more. To ensure that the progress of the last year is not lost, on-going training and industry awareness efforts are critical. In light of the Deficit Reduction Act of 1985 (Gramm-Rudman-Hollings), however, although OCC remains committed to such efforts, we may not be able to maintain the same pace during 1986. Resources have been severely strained, and it has been necessary to make across-the-board reductions in training expenditures. Moreover, District training conferences and OCC attendance at public conferences and seminars, which have been valuable vehicles for sharing information on BSA and other important topics, have been cancelled or reduced.

In addition to on-going training and education efforts, we believe that progress is essential in two critical areas if gains are to be made in the Federal Government's efforts to ensure compliance with the BSA. These areas are (1) increased coordination among the agencies with compliance and enforcement responsibilities and (2) more effective use of available data for targeting compliance and enforcement efforts.

Increased Interagency Coordination

We have great faith in the benefits which can be derived from the interagency working group process. As discussed above, the Justice Department's working group, in which we are a very active participant, has proven how effectively the bank regulators can work together with the law enforcement community. We believe this experience can be used as a model for success in the BSA area, and as an active participant in the IRS/Financial Institutions Regulatory Working Group, we are looking forward to the same accomplishments in the BSA area.

Improved Targeting

Improved communications and utilization of available BSA and other financial data could, we believe, significantly increase the return on our enforcement and compliance resources. Clearly, neither OCC nor any of the other financial institutions regulatory agencies has the resources necessary to find all compliance violations through the examination process itself. Instead, our examiners continually make judgments based on available information as to where problems are most likely to exist, targeting their efforts in an attempt to identify and correct the most serious deficiencies.

This approach is not unlike that used by the IRS in its tax enforcement efforts. Clearly, the IRS cannot and should not audit each and every taxpayer. Instead, it has been quite successful in developing statistical routines and profiles to select for audit those returns most likely to contain compliance problems. Similar efforts are needed in the BSA compliance and enforcement area.

We have had some success in targeting BSA compliance efforts using computer analyses provided to us periodically by the Customs Service. The analyses which have, for instance, identified banks whose currency shipments to or from the Federal Reserve Banks have been out of proportion to the number of Currency Transaction Reports (CRT) they have filed, have to date, focused only on certain geographic areas. We think this approach has great value and would like to see it used even more. We have actively encouraged Treasury efforts through the IRS/Financial Institutions Regulatory Working Group to increase the use of available data and to develop statistical tools for analyzing the CTRs and other financial data to target institutions for intensive compliance review. We also are working to gain on-line access to the Treasury Financial Law Enforcement Center's CTR database to permit our examiners to test, as part of their examinations, whether the CTRs in a bank's file have in fact been filed with the Treasury.

Legislative Initiatives

A great deal can be accomplished through initiatives in the two areas I have discussed -- increased interagency cooperation and coordination and improved use of available resources to target compliance and enforcement issues. We believe that additional legislation is necessary, however, to eliminate restraints on interagency cooperation and coordination and to specifically make money laundering a crime.

We agree with the general concept and intent of the various money laundering bills that have been proposed and suppprt H.R. 2785, the Administration's proposal. We in no way countenance financial institutions being used to facilitate or conceal crime and therefore we look forward to working with the subcommittee in its review of the various proposals.

Among other things, these bills would specifically make it a substantive crime for anyone to knowingly use or allow a financial institution to be used to aid someone in unlawful activities. We fully support the concept of such proposals. We believe, however, that care must be taken to ensure that the law does not proscribe inadvertent conduct by an unwitting participant.

We likewise believe that the proposed modifications to the Right to Financial Privacy Act (RFPA) are necessary to enable individuals and institutions to make referrals of suspicious activities to the law enforcement community without inadvertently exposing themselves to potential substantial liability for violations of the RFPA or other Federal or state privacy acts.

As to the new summons power given in the Administration's bill to the Secretary of the Treasury, we believe it may be appropriate under certain circumstances for that power to be delegated by the Secretary to the financial institutions regulatory agencies in order to further an examination or a civil investigation. For that reason, we support the provisions of H.R. 2785 which would authorize the Secretary to delegate the power.

The bill introduced by Representative Hughes, H.R. 1474, would make "wire and other electronic transfers" subject to being reported on a Currency or Monetary Instrument Report (CMIR).

In light of the number of wire transfers that occur between institutions daily, we doubt this provision would be cost-effective. Also, in light of the new Treasury regulation which enables Treasury to require a specific financial institution to provide copies of all wire transfers for a particular period, we do not believe such a provision is necessary.

In addition to the legislative initiatives needed to specifically address money laundering, we believe changes are needed in other laws, which may have been enacted without consideration of their potential effect on drug trafficking and money laundering problems, as the laws constitute constraints on our efforts in working with the law enforcement community. These barriers, which include the RFPA, certain state privacy acts, grand jury secrecy rules, and the procedures of various agencies, limit cooperation among Federal supervisory and law enforcement officials. While these statutes are designed to protect values we all support, they unduly restrain legitimate government information-gathering and the free flow of information between and among agencies.

We have found that the RFPA in particular has interfered with our criminal referrals and has in all likelihood degraded the ability of the recipient agency to decide which of those referrals should be pursued. Similarly, the grand jury secrecy limits prevent the law enforcement community from working closely with our office and sharing information obtained before a grand jury.

These limitations on the ability of Federal agencies to cooperate were highlighted in the Department of Justice/Financial Institutions Regulatory Working Group Agreement of April 2, 1985, with a unanimous recommendation that legislative relief be swiftly obtained. We believe that these overly restrictive statutory barriers to interagency cooperation should be examined and consideration given to reducing them so as to remove unnecessary impediments to law enforcement while at the same time protecting the important interests they were intended to preserve.

CONCLUSION

While much has been accomplished since January 1985, we recognize that more needs to be done. First, as we have indicated, we believe that continued coordination and cooperation among the agencies which share BSA compliance and enforcement responsibilities are critical. Second, greater use of available data to target compliance and enforcement efforts will, we believe, significantly increase the return on our resources. To assist us in our efforts, we encourage the Congress to consider favorably those legislative proposals before it which would eliminate present restraints on our efforts in working with the law enforcement community and their working with us.

Finally, as we have said in the past, law enforcement agencies and bank regulators alone can only provide a part of the solution. The industry's own commitment and efforts at self-policing are essential because the banks' own internal control processes are the most effective mechanisms for ensuring compliance.

With the changes we have urged and with an active interagency working group and a committed industry, we are confident that substantial additional progress in efforts to prevent the nation's financial institutions from wittingly or unwittingly being used to further criminal activities will be possible.

I would be pleased to respond to any questions you might have.

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ATTACHMENT TO THE
STATEMENT OF
ROBERT B. SERINO
DEPUTY CHIEF COUNSEL (OPERATIONS)
OFFICE OF THE COMPTROLLER OF THE CURRENCY
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
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UNITED STATES HOUSE OF REPRESENTATIVES
April 17, 1986

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I. Title I (Supervisory Authority Over Depository Institutions)

Question A.

> Specifically, is there any merit to considering giving the regulators authority to impose civil money penalties upon financial institutions for their failure to report under BSA, or should the Treasury continue to have the authority to impose such penalties?

OCC believes that the Treasury Department should continue to maintain responsibility for civil money penalties against institutions or individuals who violate the Bank Secrecy Act (BSA). Treasury, which has oversight responsibility over the BSA, is in the best position to apply the civil money penalty authority consistently against all financial institutions whether state or Federal. In addition, the purpose of the BSA is to aid law enforcement. Where there are willful violations of the statute, we believe it most appropriate for them to be handled by the law enforcement community. In any case where there are violations the OCC already has available to it a broad-based authority to take independent action under its cease and desist authorities to address any supervisory concerns which might arise. In this regard, the OCC has specifically directed that banks take corrective actions when necessary to address supervisory concerns raised by violations of the BSA. Where those violations rise to a level where they might be considered willful, the OCC has, as a matter of course, made referrals to the Treasury Department and the IRS for consideration of civil and/or criminal action. Since the beginning of 1985, OCC has made more than 75 such referrals.

Recently, OCC provided the Treasury Department and the IRS/Financial Institutions Regulatory Working Group with a series of proposed changes to the guidelines for determining when and how such referrals should be made. OCC has suggested that Treasury and the group review the guidelines and the proposed procedures to improve them, with the objective of having consistent referral procedures.

A combination of consistent guidelines and consistent application of the civil money penalty process coordinated by Treasury would appear to be the best approach to imposing civil money penalties in the BSA area.

Question B.

> To what extent could these powers be improved upon to lend support in appropriate cases to criminal law enforcement investigations?

Each of the bank regulatory agencies currently enjoys broad enforcement authority. To a large extent, this authority has proven to be adequate in dealing with violations of laws, rules, and orders which do not amount to criminal violations. Nevertheless, OCC supports certain modifications to some of its authorities which would further enhance its civil enforcement authority. These modifications include an expansion of the categories of individuals covered by OCC's cease and desist authority; adoption of less rigid standards for use of temporary cease and desist orders and removal actions; and changes to the Change in Bank Control Act (CBCA).

Also, OCC continues to support revisions to the Right to Financial Privacy Act (RFPA) and the Grand Jury Secrecy Rules which would permit a freer exchange of information between Federal law enforcement authorities and the bank supervisory agencies. Moreover, OCC supports legislative proposals that would restore the absolute immunity that has traditionally permitted a Federal employee to rigorously enforce the law without the fear of having to defend a frivolous, harassing lawsuit.

Question C.

> To what extent, if any, might the supervisory powers over depository institutions under existing law be extended to uncover criminal activities such as tax evasion, drug trafficking or money laundering, which could affect the safety and soundness of a financial institution?

As the regulatory agency responsible for the safety and soundness of national banks, OCC's primary responsibility is to ensure that banks operate in a safe and sound manner consistent with all applicable laws. Our supervisory process is geared to make such determinations. Since OCC examiners are not criminal investigators, the supervisory process is not specifically designed to ferret out evidence of criminal activity. Of course, whenever examiners uncover such evidence during the course of their examination of a bank's affairs, they clearly understand their responsibility to document and make appropriate criminal referrals to the law enforcement community.

The OCC and the other bank regulatory agencies are constantly working on ways to improve the criminal referral process. In this regard, we believe that we need to continue to develop methods of effectively utilizing our resources through, among other things, targeting and randomly selecting specific institutions for more intensive examination in the BSA area.

OCC believes that the best and most effective method of deterring criminal activity in banking institutions is to vigorously prosecute such activity when discovered. To this end, OCC has a long history of making its examiners and attorneys available to work with the law enforcement community for the purpose of resolving criminal investigations. Where deemed useful, OCC has made its examiners available to serve as agents of the grand jury to more directly assist prosecuting officials.

II. Titles VI (Change in Bank Control Act)

Question A.

> What modifications, if any, do you feel are necessary to deny acquisitions of control to unqualified or dishonest individuals?

We have supported for years the need for the Change in Bank Control Act (CBCA). We believe it is an effective means to deny ownership of financial institutions by disreputable individuals. We believe, however, that the CBCA could be improved to make it a more effective tool. We are considering specific modifications to the CBCA, which we would be happy to discuss with the Subcommittee at any time and to share suggested legislative language with you once it has received formal clearance.

Question B.

> Should more specific standards regarding what constitutes sufficient integrity or criteria be used to determine what would not be in the best interest of the depositors or the public, be included by statute or imposed by regulation?

The OCC has not defined by regulation the specific level of integrity of any proposed acquiring person or provided specific criteria to determine when it would be in the public interest that a person be denied bank control. To specify the conduct or other grounds which might provide the basis for disapproving proposed changes in bank control might unnecessarily limit our mandate to enforce the CBCA by restricting those grounds upon which disapproval of notices of change in control may be based. We are aware, however, of the Federal Home Loan Bank Board's (FHLBB) new regulation which defines the factors they will consider in assessing the integrity and competence of those applying for approval under the Change in Savings and Loans Control Act (CSLCA). We will review the Board's experience with this approach and evaluate whether a similar regulation would be effective under the CBCA for national banks.

While the OCC presently requests information in the change of control application concerning the identity, source and amount of funds that will be used for the acquisition, we recently amended the application to require disclosure of the identities of any undisclosed parties in interest. This information directly relates to the "integrity" and "public interest" determinations, and it is hoped it will permit the OCC to determine all real parties in interest to the proposed transaction.

In order for the OCC to obtain additional information on which to base its decisions in CBCA cases, we have under consideration a proposed rule that would require public notice of CBCA applications and would solicit public comments on the applicants. The rule would increase the universe from which information is gathered, enabling the OCC to benefit from the increased amount of information available in its deliberations.

Question C.

> Should the agency be given more time in which to disapprove an application for change of control (currently within 60 days, not to exceed 90 under certain circumstances)?

Changes to the CBCA which would permit the appropriate Federal banking agency to extend the period in which it may issue a disapproval or a conditional approval of a change in bank control are being considered by OCC. Such an extension in time could aid the OCC in administering the CBCA. It also could increase the benefits to be derived from the additional information the OCC expects to receive as a result of the proposed rule which would permit public comments on CBCA applications.

Question D.

> What is the standard used for the term "willful" under the Act? Does this definition create problems for the agency? Is so, what are they?

While OCC does not believe that the willfulness standard in the CBCA civil money penalty provision has created problems for the agency to date, we nevertheless believe that consideration should be given to eliminating this standard from the statute. This change would make the standard consistent with the civil money penalty standards presently contained in 12 USC §§ 93(b), 504(a), and 1818(i), and would help us deal more effectively with violations of the CBCA.

Deletion of the "willfullness" standard need not pose any threat that innocent investors would be punished for their conduct. The Federal Financial Institutions Examination Council's civil money penalty guidelines, which are used by all of the banking agencies in determining whether to assess civil money penalties, have proven to ensure fair and consistent treatment. They could be readily applied in considering whether to assess penalties for violations of the CBCA. Moreover, when considering whether to assess civil money penalties, OCC also uses additional criteria which include considerations relating to willfulness, personal benefit, and knowledge.

Question E.

> What problems, if any, is the agency incurring in obtaining sufficient relevant information on foreign nationals seeking to acquire U.S. depository institutions?

To date, the OCC has not experienced any major, recurring problems in obtaining information on foreign nationals wishing to acquire national banks. On occasion, however, problems have developed which are unique to these types of filings. The most pronounced problem has been in obtaining the information within the timeframes stated in the CBCA.

Quite often information is requested through our embassies or through foreign central banks. This process is a time-consuming one. Also, in cases involving foreign nationals, requests are made to a greater number of agencies, and since the agencies are not required to respond to us, often their responses are not timely. The information obtained from central bank and other third parties is often a major factor in the decision but, because it is not information requested of the acquirer, we do not believe the CBCA allows the agency sufficient authority to extend the timeframes in order to obtain the information. As stated previously, an expanded set of timeframes could help solve this problem.

Another problem, which is encountered rarely but is very significant, is the inability to use information provided to us by other U. S. Government agencies, foreign regulators, or other parties because of limitations placed on the use of this information by these parties. On occasion, information reflecting negatively on an acquirer's character is obtained but is furnished under a requirement that it cannot be disclosed. Because the reasons for any disapproval must be given to the acquiring party, this information may be, in effect, useless. In addition, the OCC may be unable to gain access to certain information due to current requirements of law. *See, e.g.*, The Grand Jury Secrecy Rule 6(e), Fed. R. Crim. P. As we have noted repeatedly, we believe significant steps need to be taken to permit better sharing of information.

III. Title XI (Right to Financial Privacy Act)

Question A.

> As you know, the Right to Financial Privacy Act gives individuals notice of, and a right to challenge, federal government agency requests for their bank records. In 1978 this committee sought to strike a balance between a customer's right of privacy and the need of law enforcement agencies to obtain financial records pursuant to legitimate investigations. Today, our goals are not any different from what they were in 1978. However, some law enforcement officials have suggested that the 1978 Act is at times an impediment to legitimate law enforcement investigations. Indeed, the Administration's bill, H.R. 2785, would deny the customer's financial privacy protection under the Act under certain circumstances. The subcommittee would welcome your comments on the experiences you have had with Right to Financial Privacy concerns, and whether in your opinion amendments to the Right to Financial Privacy Act are warranted.

On numerous occasions, OCC has expressed its frustrations with the restrictions imposed by the Right to Financial Privacy Act (RFPA) on the free exchange of information between the bank regulatory agencies and Federal law enforcement officials. That frustration has not abated. The RFPA in particular has interfered with our criminal referral process preventing us from providing full information with our initial referrals and, consequently, has affected the recipient agency's ability to determine effectively which referrals should be pursued.

Under the RFPA, the OCC has been limited on the quantity of information that could be provided in a criminal referral absent a post-transfer notice to the customer(s) involved. Post-referral notifications always run the risk of premature disclosure of criminal investigations, raising the possibility of evidence disappearing, witnesses failing to come forward, and defenses being manufactured. Recognizing this, OCC has, as a matter of course, made referrals in such a manner as to avoid the necessity of such notice.

It is difficult to determine what impact this approach has had on the prosecution of cases referred by OCC. Referrals with limited information, of necessity, cannot always adequately convey the depth or significance of a given criminal offense. Moreover, it is difficult for the Department of Justice to adequately assess the strengths and weaknesses of a potential bank fraud case unless it is able to evaluate these factors. A proper evaluation requires access to all of the facts which may bear on the significance of the criminal activity. Nevertheless, the restrictions imposed by the RFPA prevent this type of analysis from taking place at the time of the initial referral.

It is only after a grand jury subpoena has been served and the documents are examined that an appropriate evaluation can be made. Likewise, in order for us to protect our examiners from inadvertently violating the RFPA when they meet with law enforcement officials to discuss cases, we have generally required a grand jury subpoena. One obvious problem presented by this approach is that it creates unnecessary barriers to providing information and in most cases requires several contacts and delays before all of the relevant facts are in the hands of the prosecutor.

While OCC has attempted through oral contacts with the U.S. Attorneys' offices, to minimize any damage that could be done by these impediments, the initial lack of a full written explanation of the basis for the criminal referral, has, in OCC's judgment, unnecessarily impeded the law enforcement process.

It is very difficult to quantify the extent to which the RFPA has actually impeded an investigation or to what extent a lack of information influenced a decision to not pursue a case. We do know, however, that the limitations, either actual or perceived, have unreasonably hindered full cooperation among and between the banking agencies and the law enforcement community. The Justice/Financial Institutions Regulatory Working Group in the final Agreement of April 2, 1985, unanimously concluded that restraints like the RFPA should be modified if the Government is to coordinate effectively its efforts in its battle against all types of crime.

We have long maintained that these limitations could be significantly relaxed without any significant intrusion into privacy rights, with an amendment such as that contained in the Administration's bill, H.R. 2785. The bill's provisions would not intrude on any right of privacy as they would only allow information already legally in the hands of the Government to be used by other agencies of the Government for law enforcement purposes. The purposes of the RFPA, to prevent the extra-legal use of bank records, would be preserved.

Money Laundering Bills

Several bills now before the House would create a new crime of money laundering. They prohibit a person from engaging in a financial transaction with criminally derived property, knowing that the property is criminally derived. We support fully these bills' intent to prevent anyone, whether inside or outside of a financial institution, from knowingly using the institution to launder funds. We agree particularly that the knowing standard should be maintained to ensure that individuals or institutions are not subject to severe criminal penalties for inadvertent violations. We similarly endorse the enhanced penalties and suggest that the size of any monetary penalty be based on various factors, including the culpability of the individual or institution and the financial solvency of the violator.

We believe that the provisions in the bills that would modify the RFPA and that would preempt state law are necessary to enable individuals or institutions to make referrals to the law enforcement community of suspicious activities without inadvertently exposing themselves to potential substantial liability for violations of the RFPA or other Federal or state privacy acts. Likewise, as explained in detail in our April 14, 1986 progress report to this Subcommittee in response to question 3 of the Chairman's letter of invitation of March 27, 1986, we believe that the limitations in the RFPA should not apply to Government sharing of information for law enforcement purposes once the information has been obtained through lawful processes.

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STATEMENT OF THE HONORABLE FRANCIS A. KEATING, II
ASSISTANT SECRETARY (ENFORCEMENT)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 17, 1986

Mr. Chairman and Members of the Committee:

I sincerely appreciate the opportunity to appear before you to discuss legislative responses to the problems of money laundering, especially legislative initiatives that will enhance Treasury's enforcement of the Bank Secrecy Act. This is my first opportunity to testify before Congress on this subject since I assumed the position of Assistant Secretary last December and to affirm to you my commitment to rigorous Bank Secrecy Act enforcement.

I am pleased to introduce Mr. Robert J. Stankey, the Acting Director of the Office of Financial Enforcement, who I know is a familiar figure to you, Mr. Chairman, and your staff. Mr. Stankey has been with Treasury since the inception of the Bank Secrecy Act. It is fair to say that he, more than any other person, has been responsible for the development of the Bank Secrecy Act into an effective law enforcement weapon and cornerstone in Treasury's financial law enforcement program.

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Update on Treasury's Bank Secrecy Act Enforcement

Before turning to the legislative measures under discussion, I would like to briefly update the Committee on Treasury's Bank Secrecy Act enforcement activities since my predecessor testified before you last year in your hearings following the Bank of Boston case. On February 14, 1986, we prepared for the Committee a report on these activities which we have made available for distribution today. I will highlight four topics from that report - civil penalty assessment, improved Bank Secrecy Act examination procedures, commitment of Treasury resources to Bank Secrecy Act enforcement and regulatory amendments.

Civil Penalty Assessment

First, I would like to discuss Treasury's imposition of civil penalties against financial institutions for past non-compliance. In the wake of the publicity surrounding the Bank of Boston case, and in good measure as a response to the hearing of this Committee, over sixty banks or bank holding companies have come forward to Treasury with past violations of the Bank Secrecy Act. Some have come forward as a result of bank regulatory examinations, particularly those of the Comptroller of the Currency. To date, fifteen civil penalties have been assessed under 31 U.S.C. § 5321, ranging from $112,000 to $4.75 million in the case of Bank of America.

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Other cases are under review, and we anticipate that additional penalties will be assessed shortly. In many instances, the cases are taking several months to conclude because of the time required for banks to conduct an examination of past compliance and to reconstruct past unreported transactions for late-filing of Currency Transaction Reports.

We want to emphasize that Treasury has not as yet closed the door to volunteers, and we continue to encourage financial institutions to come forward to disclose past violations. Non-volunteer banks will be dealt with more severely. Financial institutions that have not filed required Currency Transaction Reports for any reason have a continuing legal duty to do so. Banks that become aware of past non-compliance and make no effort to contact Treasury are running a serious risk. We are planning a major effort to uncover these non-volunteers. This effort will ultimately depend heavily on the support of the bank supervisory agencies.

We believe that Treasury's rigorous enforcement of the Bank Secrecy Act, including the imposition of publicly announced, substantial civil penalties, where appropriate, has contributed to enhanced awareness of the requirements of the Bank Secrecy Act. As a consequence, and as confirmed in our dealings with many banks and the increased volume of Currency Transaction Reports, we believe that overall compliance has improved and that compliance has become a high priority with many major financial institutions.

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Improved Examination Procedures

Another major initiative to ensure full compliance with the Bank Secrecy Act has been Treasury's work with bank supervisory agencies to improve and standardize Bank Secrecy Act examination procedures.

As many of the civil penalty cases and the Bank of Boston case demonstrated, the procedures being used by the examiners were not sufficient to ensure that all violations of the Act would be detected, particularly failures to report international bank-to-bank transactions. These procedures needed to be improved, and a number of other issues also had to be considered in order to make compliance examinations more effective. These issues included the maintenance of detailed workpapers, the sharing of information among bank supervisory agencies, and the uniform application of the examination procedures. To address these matters, we have had a series of meetings with the Federal bank supervisory agencies and others who have an interest in improving the procedures used by examiners for checking the compliance of financial institutions with the Bank Secrecy Act. As a result of these consultations, we expect to send final instructions on examination procedures to the supervisory agencies this week. It is axiomatic that improved and aggressive examination will foster improved compliance.

Our experience in the improvement and standardization of examination procedures made clear to me the need for ongoing interchange of ideas between Treasury and the agencies to which Treasury has delegated Bank Secrecy Act enforcement responsibility. Therefore, I am convening a permanant Interagency Working Group on Bank Secrecy Compliance, consisting of representatives of Treasury, Customs, IRS, the SEC, and the bank supervisory agencies. The group will be chaired by the Deputy Assistant Secretary (Law Enforcement) and will meet monthly or more frequently as needed. We will use this forum to discuss not only examination procedures, but mutual enforcement problems and Treasury policy initiatives including revisions to regulations.

Commitment of Treasury Resources

In July, 1985, the Treasury Department established the Office of Financial Enforcement to assist in implementing and administering the Bank Secrecy Act regulations. The establishment of this office provided a focal point for Bank Secrecy Act related activity within the Treasury Department and acknowledged the increasing importance of the Act in Treasury's law enforcement efforts. The office has broad responsibilities for the compliance activities of all agencies that have been delegated responsibilities under the Act, and there has been an increased commitment of staff resources to the office.

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In addition to the increase in the Office of Financial Enforcement, there has been a very large commitment of resources by both the Customs and the IRS. As Assistant Commissioner Wassenaar testified yesterday, the IRS has established a separate division in Detroit to handle BSA reporting matters.

Regulatory Initiatives

Since last year, we have strengthened the Treasury Bank Secrecy Act regulations in several respects. On May 7, 1985, regulations became effective that designated casinos as financial institutions subject to Bank Secrecy Act reporting and recordkeeping requirements. As evidenced in hearings by the President's Commission on Organized Crime last summer, money laundering through casinos may have been even more widespread than once thought. We believe that the new regulations have reduced the attactiveness of the use of casinos for money laundering.

A regulatory amendment pertaining to international transactions was published as a final rule last summer. Under the regulations, Treasury will be able in the future to require a financial institution or a selected group of financial institutions to report specified international transactions, including wire transfers or cashier's checks, for defined periods of time. We envision that this will require reporting of transactions with financial institutions in designated foreign locations that would

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produce information especially useful in identifying individuals and companies involved in money laundering and tax evasion. The Internal Revenue Service's Office of Criminal Investigations is developing a plan for the initial use of this regulatory authority.

We are also discussing a number of other regulatory amendments, including regulatory solutions to problems of "smurfing" and structuring transactions to avoid the reporting requirements of the Bank Secrecy Act. These revisions are being discussed within Treasury and with the Department of Justice and should be published in the Federal Register within the next few weeks. As with all amendments to the Bank Secrecy regulations, Treasury will consider carefully the financial and operational impact of regulatory changes on financial institutions as it seeks to meet the needs of law enforcement.

Legislation

I would now like to address the various proposals under discussion to bolster our attack against money laundering and to improve Treasury's enforcement of the Bank Secrecy Act.

First is H.R. 2785 and 2786 (identical bills), the "Money Laundering and Related Crimes Act," which was developed jointly by the Departments of Justice and Treasury. I would like to remark on the critical revisions to the Bank Secrecy Act contained in the bill. I understand that my colleague from the

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Department of Justice, who will testify before you next week, will address the provisions of the bill establishing the criminal offense of money laundering and related revisions to Title 18.

Most important, under H.R. 2785 and 2786 the Secretary would be given for the first time summons authority both for financial institution witnesses and documents in connection with Bank Secrecy Act violations. This authority was among the legislative recommendations in the October, 1984 report of the President's Commission on Organized Crime on money laundering and is also contained in H.R. 1945 and H.R. 1367.

The Secretary may summon a financial institution officer, or an employee, former officer, former employee or custodian of records, who may have knowledge relating to a violation of a recordkeeping or reporting violation of the Act and require production of relevant documents. This authority is essential both to investigate violations and to assess the appropriate level of civil penalties once a violation is discovered.

This authority is essential to enforcement of the Bank Secrecy Act with respect to miscellaneous non-bank financial institutions such as casinos and foreign currency brokers, which number in excess of 3,000. The responsibility for compliance review of these institutions has been delegated to the Internal Revenue Service. However, currently, the IRS summons authority is restricted to Title 26 purposes. Therefore, in examining these institutions IRS must rely on voluntary cooperation.

Under this bill, a summons would be issued only by the Secretary or with his approval by a supervisory level official of an organization to which the Secretary has delegated Bank Secrecy Act enforcement authority, e.g., the Internal Revenue Service, the Comptroller of the Currency or the Customs Service. An agent or bank examiner in the field could not issue a summons on his or her own authority. H. 1367 by contrast provides that Treasury may not delegate summons authority. For Treasury, the ability to delegate summons authority is a practical necessity.

The bill also provides for a civil penalty for negligent violations of the Bank Secrecy Act. Currently, Treasury has authority to assess civil penalties for "willful" violations under 31 U.S.C. § 5321. "Willful" in a civil penalty context means with specific intent or with reckless disregard of the law. Nevertheless, mere negligent non-filing of currency reports deprives the government of potentially useful law enforcement information to the same extent as willful non-filings. The prospect of penalties for negligent violations should encourage financial institutions to give more attention to good compliance.

H.R. 2785 and 2786 also provide important revisions to the Right to Financial Privacy Act (RFPA). The revisions to the RFPA contained in the Administration's money laundering bill can be considered as an adjunct to that bill, with application separate from the subject of criminal money laundering legislation or enforcement of the Bank Secrecy Act.

The most important and least controversial of the revisions is the amendment to subsection 1103(c) of the RFPA, 12 U.S.C. § 3403(c). Currently, § 3403(c) provides that nothing in the Act shall preclude a financial institution from notifying a government authority that the institution has information "which may be relevant to a possible violation of any statute or regulation." The statute gives no guidance on what information can be given without running the risk of exposure to civil liability under the RFPA. The proposed amendment sets out explicitly that enough information can be given to enable Federal law enforcement authorities to proceed with legal process, e.g., summons, subpoena, or search warrant, in accordance with the RFPA. This information at a minimum must include the nature of the suspicious activity, the name of the customer, and other identifying information necessary to identify the customer or the account involved.

We believe you should find very little opposition in the financial community to this particular revision of the RFPA. The revision imposes no new legal duty on financial institutions, clarifies the right of financial institutions to act as good citizens without risk of civil liability, far outweighs any jeopardy to legitimate privacy interests, and would be of major assistance to Federal law enforcement.

For consistent application throughout the United States, this amendment must be accompanied by the proposed preemption provision so that a financial institution that complies with the RFPA will not run afoul of any more restrictive state privacy laws. The proposed clarification of the "good faith defense" to civil liability is also needed to protect financial institutions who cooperate with Federal law enforcement in good faith within the confines of the RFPA.

In addition to the Administration's money laundering bill, there is another legislative initiative on which I urge early and favorable action. That is the bill discussed in this Committee yesterday by Congressman Pickle.

This bill would prohibit structuring of currency transactions to avoid the $10,000 currency transaction reporting requirement. Structuring includes the well-known practice of "smurfing." Recent decisions in three Federal Circuits have made it clear that the current law is inadequate to sustain consistent prosecutions for structuring. The proposal would make a person who structures transactions to avoid the currency reporting requirements, or who causes a financial institution not to file a required report, subject to the criminal and civil sanctions of the Bank Secrecy Act.

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The bill also provides seizure and forfeiture authority for currency related to a domestic (CTR) reporting violation or interest in property traceable to the currency. The forfeiture would not affect bona fide purchasers who took the currency or property without notice of a reporting violation. Currently, there is forfeiture authority only for monetary instruments underlying violations of the reporting requirements for internationally transported monetary instruments. The forfeiture would not be applicable to domestic financial institutions examined by a federal bank supervisory agency or a financial institution regulated by the Securities and Exchange Commission.

With respect to the other bills before the Committee, Treasury opposes two provisions in H.R. 1474. Section 3 of H.R. 1474 would provide that every Bank Secrecy Act reporting exemption be approved by the Secretary. Under the current regulations (31 C.F.R. § 103.22(b)), a bank may exempt from reporting certain cash deposits and withdrawals of accounts of retail businesses in amounts commensurate with the lawful, customary conduct of such a business. The bank has a continuing duty to monitor the qualifications for such exemptions, and it would be unwise, in our view, to shift the burden of monitoring the eligibility of bank customers for exemptions away from the bank. The bank is in the best position to know its customers and changes in their status. The provision is accordingly inefficient, overly burdensome and unnecessary.

Section 4 of H.R. 1474 would require that every person, including every financial institution, report all outgoing international wire transfers. As discussed above, with respect to Treasury's new international transaction reporting regulations, Treasury already has authority under 31 U.S.C. § 5314 to require reporting of international wire transfers. However, wholesale reporting of international wire transfers would not be in keeping with the restriction of § 5314 that Treasury consider the need to "avoid burdening unreasonably a person making a transaction with a foreign financial agency." This broad reporting requirement would create a virtual blizzard of reports, burdening financial institutions out of all proportion to the utility of the information generated and would bury the Treasury Department in an avalanche of reporting forms, all but a very few of which would be unrelated to money laundering.

I would now like to turn to H.R. 4280. This bill would make two major changes to the Bank Secrecy Act. First, it would amend 31 U.S.C. § 5313 to provide that the Treasury could only require reporting of domestic currency transactions in excess of $10,000. As you know, $10,000 is the reporting amount currently under Treasury regulations. We disagree strongly with this restriction on Treasury rulemaking flexibility and the ability to respond to changing law enforcement needs. There may be instances where the $10,000 reporting trigger is too high. For example, we have discussed various ways to address the smurfing problem by regulatory changes. One idea that has been circulated within

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Treasury is to require reports at the time of cash purchases of cashier's checks in excess of $3,000. This reporting requirement or similar use of the regulations to address such changing law enforcement problems would be precluded by H.R. 4280.

Another provision of H.R. 4280 would require a financial institution to keep special records relating to any cash transaction in excess of $3,000. Similar proposals have been under discussion within Treasury and within the Department of Justice as regulatory solutions to the various schemes being used to avoid the currency reporting requirements. We believe that a regulatory rather than legislative response is appropriate to address these situations, so that we can maintain the flexibility to respond to changing law enforcement needs. Moreover, in considering any proposal that imposes a new requirement on financial institutions, we must assess the cost and administrative burden to financial institutions in relation to the law enforcement interests served.

Another bill introduced by Congressman Wortly provides that Treasury review all exemptions not less than once a year and "in any case in which there is a change in management or control of a financial institution." As we have discussed above with respect to H.R. 1474, the annual review of all exemptions is a practical impossibility. However, we would have no objection to the review of exemptions when there is a change in control. We generally support increased attention to Bank Secrecy Act compliance at the time of changes in control.

Finally, Mr. Chairman, I want to express my appreciation for the continuing interest and support that you and the other members of this committee have demonstrated for Treasury's administration of the Bank Secrecy Act.

This concludes my prepared remarks. Mr. Stankey and I would be pleased to answer any questions the Committee may have.

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DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

May 20, 1986

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Banking, Finance & Urban Affairs Committee

Dear Chairman St. Germain:

Enclosed are our written responses to the questions you posed to me following my testimony on April 17th.

I very much appreciated the opportunity to appear before the Committee. Your sustained interest in Bank Secrecy Act enforcement, especially in good quality examination by bank supervisory agencies, is essential to Treasury's Bank Secrecy Act enforcement objectives.

If you have any further questions or if Treasury can be of any further assistance with respect to the legislation you are drafting, please do not hesitate to call on me or my staff.

Sincerely,

Frank A. Keating, II
Assistant Secretary
(Enforcement)

The Honorable Fernand J. St. Germain
Chairman, Committee on Banking,
  Finance and Urban Affairs
United States House of Representatives
Washington, D. C. 20515

Enclosures

1. Treasury is not seeking summons authority to obtain a bank customer's records, but rather to obtain records and testimony relating to the Bank Secrecy Act compliance of the financial institution itself. The summons authority proposed in H.R. 2785 and 2786 is limited to examination of financial institution records and testimony of financial institution employees for purpose of investigating civil violations of the Bank Secrecy Act. The records of individual customers will be incidental to this review, just as they are to reviews by bank examiners of a financial institution for safety and soundness. Treasury is considered a bank supervisory agency for Title 31 enforcement under the Right to Financial Privacy Act.

As we testifed, this authority is especially needed with respect to the 3000 miscellaneous non-bank financial institutions such as casinos, foreign currency brokers, transmitters of funds and sellers of travelers checks for which examination responsibility has been delegated to the Internal Revenue Service. IRS now depends on the voluntary cooperation of these institutions in the examination process and has no means to compel cooperation.

a) In the case of a non-bank institution, the summons would be used when Treasury had information regarding non-compliance or when cooperation was inadequate in the examination process. With respect to banks, we expect that we would most frequently use the summons when a bank was being uncooperative or unforthcoming in a civil penalty case or to follow up on information regarding noncompliance developed in a bank examination. We have not drafted any specific written criteria for use in advance of the legislation.

b) As set forth above, the focus of the summons is not the bank customer. We do not believe that there is undue potential for abuse of the legitimate customer's privacy rights any more than is the case with any bank examination process.

2. Since June of last year, we have assessed civil penalties against sixteen banks or bank holding companies. A number of other cases are under review and should be announced over the course of the next several months. The nature and extent of the violations varied, as is reflected in the dollar range of the penalties -- $4.75 million in the case of Bank of America to $112,000 in the case of Barnett Banks of Florida. The violations for which penalties have been assessed are of three general types: 1) failure to report currency transactions with foreign correspondent banks and domestic foreign currency brokers, 2) improper exemption of customers, and 3) general non-reporting of currency transactions unrelated to exemption list problems. Some of the banks had all three types of violations, some only one or two. The violations of some of the banks have been found throughout the banks unit or branches. In others, the violations

were limited to one unit or department.

3. Treasury takes many factors into consideration in assessing civil penalties, including the nature and number of the violations, the degree of cooperation Treasury has received from the bank in developing the scope of the bank's liability, the size of the bank, the adequacy of the bank's past compliance program and to a lesser extent, the financial condition of the bank. We make every effort to treat similarly situated banks in a similar manner, but have no set formula. The dollar amount of the penalty is generally keyed to the number of non-filings.

4. As we have testified and reported to the Committee earlier, after a series of meetings with the supervisory agencies, Treasury has developed standard Bank Secrecy Act examination procedures and disseminated those procedures to the supervisory agencies. (Copy attached). Common past compliance problems such as the failure to report currency transactions with foreign banks were also discussed.

5. By the end of this month, we hope to disseminate exemption guidelines to the bank regulatory agencies. This should be very helpful, not only in the examiner's identification of exempt list violations, but in assisting the examiners to explain proper exemption procedures to the institutions they examine.

6. The new IRS Form 4789 will not be in use until July 1, 1986.

The form will improve financial institutions accountability by requiring two signatures--one of the financial institution employee who prepares the form and one by a reviewing official. (A copy of the new form is attached.)

The form also has been revised in many ways to improve the quality and use of the information received. For instance:

- The new revised form provides more complete line-by-line instructions for the financial institution to use in completing the form.
- The new form provides a space (line item 13) for the financial institution to indicate why an individual is not identified in Part I. The new form will contain a space (line item 19.b. of Part II) to indicate whether the organization for whom the transaction was conducted is a securities broker or a non-bank financial institution. With this information the Securities Exchange Commission or Internal Revenue Service can be provided with information about the types of financial institutions they regulate for Bank Secrecy Act compliance.
- Part IV has been changed to provide for more types of cash transactions and to indicate if a transaction is "cash in" or "cash-out." This will provide for better analysis of the data for targeting purposes. It will especially provide a basis for monitoring cash transactions with foreign financial institutions.
- Part V of the form provides a better way for a financial

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institution to indicate what type of institution it is. With this information, summary reports of Bank Secrecy Act information can be provided to the supervisory agency that regulates the specific type of financial institution. A special code number (in box 36a.) will indicate who the supervisory agency is for banks.

- The bank identification number will provide for analysis of the data by Federal Reserve Districts. This will be useful for conducting currency flow studies to target banks for possible non-compliance.

7. The IRS has been delegated authority to examine compliance by casinos and to monitor the agreement with the State of Nevada whereby Nevada casinos report currency transactions to the State which in turn reports the information to Treasury. IRS has not advised Treasury of any major problems with respect to casino compliance with the Bank Secrecy Act.

8. We receive and review excerpts of the examination reports relating to Bank Secrecy Act compliance that the supervisory agencies give to the examined institutions. We can review the underlying workpapers on request. We have not had an occasion to evaluate how the examiners document the examination process.

9. The model examination procedures direct examiners to review activities of all bank cash areas, not just teller transactions.

10. Upon request, the Federal Reserve banks provide Treasury with information regarding currency surpluses by banks in a given district. Treasury can then analyze that information and compare it to Currency Transaction Report levels of the banks. In this way, potential violators can be identified. Such an analysis as you know, identified institutions in the New England area, such as Bank of Boston. Customs did such an analysis last summer of banks in Louisiana, which was forwarded to the supervisory agencies. A similar analysis is being done now of banks in Texas.

11. As set forth above, we are now satisfied that banking regulators have detailed Bank Secrecy examination procedures and we have been assured that they will apply those procedures.

12. Bank examiners have not been provided systematically with records of the BSA forms that have filed in order to verify that examined institutions have actually filed the forms. Bank examiners have brought to our attention that this information would be a useful. We are considering ways to address this problem, *e.g.*, giving the examiners limited on-line access to the Bank Secrecy Act data base for this purpose.

13. The regulation that authorizes Treasury to select banks for special reporting of transactions including wire transfers, with foreign financial agencies became effective July 8, 1985. The Internal Revenue Service Criminal Investigation Division is currently developing a pilot program for the use of this

regulatory authority. We are hopeful that this new regulation will be very effective in detecting illegal actiivity, focusing Treasury's financial enforcement efforts and identifying needs for international law enforcement cooperation initiatives.

14. We believe that the term "monetary instruments" under the BSA does include postal money orders, if they are issued in blank or to a fictitious payee. However, Treasury has not designated the Postal Service as a financial institution subject to the reporting and recordkeeping provisions of the Act. As testimony before your Committee demonstrated, postal money orders may be the next frontier for money launderers as Bank Secrecy Act compliance by financial institutions improves. As a direct result of the hearing, we intend immediately to discuss the problem with the Postal Service.

FERNAND J. ST GERMAIN, RHODE ISLAND, CHAIRMAN

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NINETY-NINTH CONGRESS
ROOM B-303 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6051

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April 25, 1986

Mr. James Dudine
Chief
Special Activities Section
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Dear Mr. Dudine:

The Subcommittee appreciates your appearance at our hearings last Thursday. Your testimony is of great assistance in our review of the Bank Secrecy Act and other pertinent issues.

There are several questions which the Subcommittee would like to have you answer and which will be submitted for the record. They are as follows:

1. Both Mr. Serino, of the Office of the Comptroller of the Currency, and Mr. Woodard, of the Internal Revenue Service, in their testimony, express support for amending Title 31 of the Bank Secrecy Act via the Administration's Bill (H.R. 2785) to permit the issuance of a summons to a bank, or its employees, for a bank customer's records. This raises some questions about balancing the need for effective investigations of BSA non-compliance with a bank customer's right to privacy.
    a) What criteria do you propose for use of the summons?
    b) How do you intend to prevent this power from abusing the privacy rights of the legitimate customer?

2. Concerning names and businesses which may inappropriately appear on a financial institution's exempt list, presently, how does your agency ensure

that appropriate entities are on such lists? Assuming there is an unqualified name or business on such a list, what types of enforcement action would your agency pursue? At present, would civil or criminal liability be possible against either the financial institution or its exempted customer for inappropriately appearing on such a list?

3. Should the term "monetary instruments" in the Bank Secrecy Act and its regulations be amended to include "postal money orders" in order to include them under the requirements of the Act and its regulations?

4. Has any thought been given to the use of the civil money penalty provisions of the Financial Institutions Regulatory and Interest Rate Control Act, with appropriate amendments, in connection with violations of the Bank Secrecy Act by financial institutions and their employees? Present delays caused by extended negotiations and record review to determine "willfulness" possibly could be minimized.

Again, the Subcommittee is appreciative of your efforts in this area. Please submit your responses to the Subcommittee no later that May 7, 1986.

Sincerely,

Fernand J. St Germain
Chairman

FStG:sTf

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF THE CHAIRMAN

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Subcommittee on Financial Institutions

May 16, 1986

Honorable Fernand J. St Germain
Chairman, Subcommittee on Financial Institutions
  Supervision, Regulation and Insurance
House of Representatives
Washington, D.C. 20515-6051

Dear Mr. Chairman:

In your April 25, 1986 letter to James R. Dudine, Chief of the Special Activities Section, you asked the FDIC to respond to four additional questions pertaining to the Subcommittee's review of the Bank Secrecy Act. Our responses to these questions appear in the attachment.

Sincerely,

L Wm Seidman

L. William Seidman
Chairman

Attachment

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RESPONSE TO QUESTIONS PRESENTED IN THE APRIL 25, 1986 LETTER FROM THE CHAIRMAN, SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE.

1. Question: Both Mr. Serino, of the Office of the Comptroller of the Currency, and Mr. Woodard, of the Internal Revenue Service, in their testimony, express support for amending Title 31 of the Bank Secrecy Act via the Administration's Bill (H.R. 2785) to permit the issuance of a summons to a bank, or its employees, for a bank customer's records. This raises some questions about balancing the need for effective investigations of BSA non-compliance with a bank customer's right to privacy.

a) What criteria do you propose for use of the summmons?
b) How do you intend to prevent this power from abusing the privacy rights of the legitimate customer?

1. Answer: The summons authority provided in H.R. 2785 would be applicable to Treasury and its component agencies, the IRS and the Customs Service. Bank regulatory agencies would continue to use their supervisory authority to determine compliance with the Bank Secrecy Act (BSA). It is our understanding that the proposed summons authority would be used primarily in investigations of miscellaneous nonbank financial institutions such as casinos and foreign currency brokers. Under the proposal, a summons would be issued only by the Secretary of the Treasury or with the Secretary's approval precluding any indiscriminate use of the summons by field agents.

Since the summons authority is not directed at bank customer records, privacy rights of bank customers would not be affected one way or another. Customers of nonbank financial institutions might perceive this authority as a potential incursion into their privacy; however, customers of those institutions should have no greater expectation of privacy than customers of banks where violations of federal law are suspected and bank customer records are already subject to regulatory review.

2. Question: Concerning names and businesses which may inappropriately appear on a financial institution's exempt list, presently, how does your agency ensure that appropriate entities are on such lists? Assuming there is an unqualified name or business on such a list, what types of enforcement action would your agency pursue? At present, would civil or criminal liability be possible against either the financial institution or its exempted customer for inappropriately appearing on such a list?

2. Answer: FDIC examiners review the financial institution's exempt list during each BSA compliance examination to ensure that exempt customers meet the criteria outlined in 31 CFR 103.22 and that all required information is included on the list. Any questionable exemptions are discussed with bank

management either directly or after conferring with the FDIC's Regional compliance specialist. If the question cannot be resolved in this manner, the bank is asked to submit the facts of the situation to Treasury for an official ruling on the propriety of the exemption.

If an exemption is clearly improper, the bank is required to revoke the exemption; and the bank is directed to file CTRs on all reportable transactions for that customer. The improper exemption is cited in the report of examination as a violation. As a follow-up measure, the FDIC directs the violating bank to explain the corrective measures it has taken to eliminate all future violations concerning that customer and to review and correct, where appropriate, its exempt list practices. Cases of serious abuse of the exemption privilege are referred to Treasury for civil or criminal enforcement.

Under the present law, criminal action can be taken against a bank or its customers for willfully structuring exemptions to further illegal activity. Such cases are difficult to make, however, because bank management has considerable latitude under the regulations in granting exemptions; and it is easy to characterize an inappropriate exemption as an honest mistake. Since the bank makes the decision to grant an exemption, it is even more difficult to hold the customer liable for the violation.

3. Question: Should the term "monetary instruments" in the Bank Secrecy Act and its regulations be amended to include "postal money orders" in order to include them under the requirements of the Act and its regulations?

3. Answer: The term monetary instruments includes money orders in bearer form. We have always considered this definition to cover "postal money orders" in bearer form as well as those issued by financial institutions. However, in responding to this question we asked the Treasury Department for its views and were informed that "postal money orders" were not covered. According to Treasury, the term "money orders" in the BSA means only money orders issued by financial institutions. Others, including some Justice Department prosecutors, also apparently hold the view that "postal money orders" are covered by Title 31.

This is not the only technical problem with the language of Section 103.11. In order to meet the definition of monetary instrument in that section, bank checks, travelers checks and money orders cannot contain the name of the payee. It is a simple process to put the name of a fictitious payee on the instrument to avoid the reporting requirements. Obviously, to avoid loopholes in the ambit of Title 31, all money orders should be included regardless of their origin. Consideration should also be given to imposing penalties for using fictitious payees to avoid the reporting requirements.

4. Question: Has any thought been given to the use of the civil money penalty provisions of the Financial Institutions Regulatory and Interest Rate Control Act, with appropriate amendments, in connection with violations of the Bank Secrecy Act by financial institutions and their employees? Present delays caused by extended negotiations and record review to determine "willfulness" possibly could be minimized.

4. Answer: As you are well aware, under current law, FDIC cannot assess civil money penalties for violations of the BSA. We can, however, issue cease and desist orders or enter into memoranda of understanding (MOU) with bank officials to effect correction. While MOU's have been used in a number of cases, we have issued a much smaller number of cease and desist orders for violations of the BSA. We have preferred to follow the civil money penalty procedures worked out between bank regulators and the Treasury Department. As we have previously stated, our recommendations to Treasury for assessment of CMP's to correct continuing violations due to improper procedures and to address the continuing disregard for BSA regulations by recalcitrant bank officials have not been pursued on these bases.

As was stated in testimony before your Subcommittee on April 20, 1986, the newly formed working group comprised of Treasury and bank regulatory officials is addressing the apparent ineffectiveness of the civil money referral process to deal with this problem. We believe that, with Treasury's support, an effective process can be devised to better utilize the civil money penalty power already granted to the Secretary of the Treasury. We believe that the authority to assess civil money penalties for BSA violations should remain with the Treasury. Should the working group fail to develop an effective civil money policy, one that gives bank regulators some assurance that referrals will be acted on promptly by the Treasury Department, the FDIC is prepared to make greater use of its supervisory authority, to include both informal and formal administrative action, where circumstances warran

FERNAND J ST GERMAIN RHODE ISLAND CHAIRMAN

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TOBY ROTH WISCONSIN

April 25, 1986

Mr. Robert B. Serino
Deputy Chief Counsel (Operations)
Comptroller of the Currency
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20219

Dear Mr. Serino:

The Subcommittee appreciates your appearance at our hearings last Thursday. Your testimony is of great assistance in our review of the Bank Secrecy Act and other pertinent issues.

There are several questions which the Subcommittee would like to have you answer and which will be submitted for the record. They are as follows:

1. Both you and Mr. Woodard, of the Internal Revenue Service, in your testimony, express support for amending Title 31 of the Bank Secrecy Act via the Administration's Bill (H.R. 2785) to permit the issuance of a summons to a bank, or its employees, for a bank customer's records. This raises some questions about balancing the need for effective investigations of BSA non-compliance with a bank customer's right to privacy.
    a) What criteria do your propose for use of the summons?
    b) How do you intend to prevent this power from abusing the privacy rights of the legitimate customer?

2. Concerning names and businesses which may inappropriately appear on a financial institition's exempt list, presently, how does your agency ensure that appropriate entities are on such lists? Assuming there is an unqualified name or business on such a list, what types of enforcement action

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would your agency pursue? At present, would civil or criminal liability be possible against either the financial institution or its exempted customer for inappropriately appearing on such a list?

3. Should the term "monetary instruments" in the Bank Secrecy Act and its regulations be amended to include "postal money orders" in order to include them under the requirements of the Act and its regulations?

4. In your testimony, you noted that the Comptroller's office is considering requiring public notice of Change in Bank Control Act applications in order to solicit public comment on those applications. This suggests a continuing weakness on the part of our bank regulatory agencies to obtain information about individuals seeking control of our financial institutions. There is growing concern on the Subcommittee about certain individuals seeking control of financial institutions for dishonest purposes. While we encourage your best efforts and thoughts in this area, what has been the reaction thusfar to your proposal?

5. Has any thought been given to the use of the civil money penalty provisions of the Financial Institutions Regulatory and Interest Rate Control Act, with appropriate amendmants, in connection with violations of the Bank Secrecy Act by financial institutions and their employees? Present delays caused by extended negotiations and record review to determine "willfulness" possibly could be minimized.

Again, the Subcommittee is appreciative of your efforts in this area. Please submit your responses to the Subcommittee no later that May 7, 1986.

Sincerely,

Fernand J. St Germain
Chairman

FStG:sTf

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Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

May 12, 1986

Dear Mr. Chairman:

I appreciated the opportunity to testify before your Subcommittee last month on the OCC's efforts under the Bank Secrecy Act and to provide you with our thoughts on what legislative changes are needed to assist us in our efforts. By letter of April 25, 1986, you asked that I respond for the record to five questions raised by the Subcommittee. My answers are set forth in an enclosure to this letter.

Additionally, as I indicated in my testimony, I believe that the amendments to the Right to Financial Privacy Act proposed in the Administration's bill, H.R. 2785, are extremely important to our enforcement efforts. Agencies should be permitted to transfer freely to appropriate enforcement agencies any information lawfully in their possession, when the information is relevant to a matter within the receiving organization's enforcement jurisdiction.

I would be pleased to provide additional information or to discuss any of these matters further at any time with you or your staff.

Sincerely,

Robert B. Serino
Deputy Chief Counsel (Operations)

The Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
 Supervision, Regulation and Insurance
Committee on Banking, Finance and
 Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Enclosure

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Answers to Questions
Submitted by the
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and Urban Affairs
United States House of Representatives
to
Robert B. Serino
Deputy Chief Counsel (Operations)
Office of the Comptroller of the Currency

May 12, 1986

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Question 1

Both you and Mr. Woodard, of the Internal Revenue Service, in your testimony, express support for amending Title 31 of the Bank Secrecy Act via the Administration's Bill (H.R. 2785) to permit the issuance of a summons to a bank, or its employees, for a bank customer's records. This raises some questions about balancing the need for effective investigations of BSA non-compliance with a bank customer's right to privacy.

- a) What criteria do you propose for use of the summons?
- b) How do you intend to prevent this power from abusing the privacy rights of the legitimate customer?

In his testimony regarding the summons authority on April 17, 1986, Assistant Secretary Keating expressed the Treasury Department's view that "this authority is essential both to investigate violations and to assess the appropriate level of civil penalties once a violation is discovered. This authority is especially needed for enforcement of the Bank Secrecy Act with respect to miscellaneous non-bank financial institutions."

The primary value of such summons authority would appear to be in the area of non-bank financial institutions. The Comptroller's Office already possesses broad authority to review the books and records of any national bank. In aid of that authority, the provisions of 12 U.S.C. §1820(c) which, in turn, incorporate the provisions of 12 U.S.C. §1818(n) clearly provide the Office with the authority to subpoena documents and information from national banks in connection with an examination or "other types of investigations to determine compliance with applicable law and regulations".

To the extent that a specific summons would be nevertheless necessary in an investigation of Bank Secrecy Act violations, Assistant Secretary Keating proposed that a "summons would be issued only by the Secretary or with his approval by a supervisory level official of an organization to which the Secretary has delegated Bank Secrecy Act enforcement authority". He stressed that under the law an agent or bank examiner in the field could not issue a summons on his or her own authority. Placing approval authority of any summons at a relatively high level of the agency should serve to provide the necessary safeguards against any potential for abuse.

With respect to the criteria which should be utilized in determining whether to issue a summons, I suggest that with the requirement for supervisory level authorization the "reason to believe" standard should be sufficient to justify the issuance.

In other words, if the agency has reason to believe that violations of the Bank Secrecy Act have occurred or may be occurring, a summons could issue upon such a showing.

As indicated above, the major impediment facing OCC's compliance and enforcement efforts under the BSA has not been restrictions on information gathering, but rather has been the restrictions on information sharing under the RFPA. As discussed in my testimony, these restrictions impede important communication and coordination within the law enforcement community. Once data has been lawfully obtained by a government agency, that agency should be free to share the information fully with other enforcement agencies, when the information is relevant to matters within the jurisdiction of the receiving agency. To ensure that requests for information are only related to legitimate law enforcement purposes, we would suggest that they be initiated and approved at relatively high levels of the requesting agency and that they be directed to a correspondingly high level at the agency from which the information is being sought. Such limits would serve to provide safeguards against the potential abuse that the RFPA was created to avoid.

The present procedures and limitations severely impede the effectiveness of the law enforcement agencies' efforts to enforce the laws. Notification of a transfer of information to a criminal enforcement agency has the undesired effect of putting the subject on notice of the criminal investigation. The alternative available -- applying each time for a court order permitting delayed notification -- is cumbersome and time-consuming in the context within which enforcement actions are developed. The situation is made particularly difficult because the Justice Department which is the agency which would normally request the delay, is unable to obtain at the outset the information necessary to make a case to support delay. As a result, agencies have limited their communications, and the enforcement process has suffered. Permitting agencies to transfer information already lawfully within their possession to other government agencies, without additional notice, when that information is relevant to a matter within the jurisdiction of the reviewing agency, would have little negative impact on the citizen's privacy rights and would contribute substantially to the government's ability to enforce the laws.

Question 2

> Concerning names and businesses which may inappropriately appear on a financial institution's exempt list, presently, how does your agency ensure that appropriate entities are on such lists? Assuming there is an unqualified name or business on such a list, what types of enforcement action would your agency pursue? At present, would civil or criminal liability be possible against either the financial institution or its exempted customer for inappropriately appearing on such a list?

OCC's current examination procedures instruct examiners to review the bank's list of exempt customers to determine that:

- Its contents conform to the requirements of the regulation (103.22(e)) and that the exemptions appear reasonable.

- The bank has, in granting exemptions, adhered to its established policy.

Section 103.22 of the Bank Secrecy Act identifies the types of customers a bank may include on the exemption list and sets out in detail the information to be included for each customer. The bank has the principal responsibility to determine who is authorized to be placed on the exempt list.

If in the course of reviewing the list, examiners have been unsure whether a listed customer is eligible for exemption, the examiners have sought the advice of an OCC BSA specialist or have required the bank to contact Treasury for a ruling. When violations have been noted, the banks have been requested to remove the customer from the list and begin filing Form 4789 on reportable transactions. In many cases, banks also have been required to search their records to identify reportable transactions which occurred between the time the customer was placed on the list and the date of delisting, and to file a Form 4789 for each unreported transaction.

In addition, where exempt lists have been found to be incomplete, banks have been required to provide the omitted information. Common omissions from the lists have been account numbers, types of transactions which are exempt (e.g. deposits, withdrawals or both), and the amount of the exemption.

On several occasions examiners have challenged the amount of an exemption established by a bank. The amount of an exemption must be commensurate with the customary conduct of the lawful, domestic business of the customer. When challenged, the bank has been required to provide data to support the exemption limit. Depending upon the data provided, the bank may be required to remove the customer from the exempt list or to adjust the exclusion amount. Again, in some cases the bank has been required to back file Form 4789's.

Depending upon the severity of the problems noted, additional enforcement measures have been taken. For instance, provisions in our enforcement documents have dealt specifically with violations of the Bank Secrecy Act. Such provisions have included, in addition to the specific requirements to correct outstanding violations, a requirement to establish a system of internal controls to ensure compliance with the Bank Secrecy Act. Language currently being used by OCC to deal specifically with the exemption area includes a requirement for banks to develop written policies and procedures for complying with the exempt list requirements.

In addition to identifying and requiring correction of violations and requiring the adoption of better internal controls, if the violations are serious enough, we also will make a referral to the Treasury Department for consideration of civil and/or criminal penalties. We are currently working with Treasury and the Bank Secrecy Act Working Group to finalize criteria for making such referrals. We also are working with the Bank Secrecy Act Working Group to give additional guidance to the banking industry on how to better comply with the regulations dealing with the exempt list.

Civil and criminal liability for violations of the Bank Secrecy Act hinge on whether the violations are considered to be "willful". We believe the term willful means "action taken knowingly, consciously, intentionally or with reckless disregard." In the criminal context, we believe that, in addition, there would have to be a knowing violation or a specific intent to violate the law.

We are developing a Policies and Procedures Manual issuance to be used in determining when a referral is appropriate. A draft is currently undergoing review by the Treasury Department Working Group.

Question 3

> Should the term "monetary instruments" in the Bank Secrecy Act and its regulations be amended to include "postal money orders" in order to include them under the requirements of the Act and its regulations?

Money orders are already included by regulation within the definition of the term "monetary instruments," 31 CFR 103.11, if they are in bearer or similar form. Thus, like bank checks and traveler's checks, money orders which have been made payable to the order of a named person and which have not been endorsed or which bear restrictive endorsements are not included within the meaning of the term. We understand that the real enforcement problem has arisen because of this bearer form restriction, particularly with respect to checks and orders made out to fictitious payees. The Administration's bill, H.R. 2785, addresses this problem by proposing to amend the statutory definition of "monetary instruments" to include non-bearer material.

If your interest also is to ensure that postal money order purchases are covered by the reporting requirement, you also may wish to address whether the Postal Service should be included under the definition of the term "financial institution."

Your underlying question--whether postal money orders are posing a significant enforcement problem such that action should be taken to include them within the scope of the BSA--would be more appropriately addressed to the Treasury Department and the Postal Service. Our experience with postal money orders and any enforcement problems relating to them is extremely limited. The Treasury and the Postal Service would be in the best position to evaluate the extent to which postal money orders are being used in money laundering schemes and would be best able to advise you.

Question 4

> In your testimony, you noted that the Comptroller's office is considering requiring public notice of Change in Bank Control Act applications in order to solicit public comment on those applications. This suggests a continuing weakness on the part of our bank regulatory agencies to obtain information about individuals seeking control of our financial institutions. There is growing concern on the Subcommittee about certain individuals seeking control of financial institutions for dishonest purposes. While we encourage your best efforts and thoughts in this area, what has been the reaction thusfar to your proposal?

As we stated in our earlier submission to the Subcommittee, while we believe that the Change in Bank Control Act (CBCA) is an effective means to deny ownership of financial institutions to disreputable individuals, we believe the statute could be improved to make it a more effective tool. No matter how much information we are able to obtain, there will always be cases in which additional information would be useful. We do not believe that information gaps have seriously affected our CBCA program. We are sensitive, however, to the possibility of such an event and are seeking to utilize all available sources to ensure that we have as much information as possible on which to base our decisions.

Our proposal to require public notice of CBCA applications is part of this continuing effort. Public announcement of such notices is consistent with the OCC's practices relating to the chartering of new national banks and the merger of existing institutions, where public notice of charter and merger applications currently is required. It also is consistent with the recommendations contained in the Committee on Government Operations, Federal Response to Criminal Misconduct and Insider Abuse in the Nation's Financial Institutions, H.R. Rep. 98-1137, 98th Cong., 2d Sess., at 20. Moreover, the FDIC has recently adopted a nearly identical rule. 51 Fed. Reg. 10800 (March 31, 1986).

The proposal generated little reaction when it was published as a Notice of Proposed Rulemaking, on May 7, 1985. At that time we solicited response to the following two questions:

1. To what extent would early release of the fact that a notice has been filed, the identity of the bank, the identity of the proposed acquiror, and the earliest date the transaction could be consummated, be useful in eliciting information from the community as to whether a notice of disapproval should be issued?

2. To what extent would the interest of a person filing a notice be prejudiced by the early disclosure of its existence?

Six comments were received -- three in favor and three opposed. In support of the proposal, it was argued that if an acquisition were for a lawful purpose, and the acquirors intended to operate a national bank lawfully, no prejudice should occur due to the early disclosure of the information contemplated by the proposed rule. The rule would make the disclosure requirements of the CBCA comparable to those under the Bank Merger Act and the Bank Holding Company Act, and would be compatible with the requirements of the Williams Act Amendments to the Securities Exchange Act of 1934, concerning tender offers. Moreover, the disallowance of a CBCA notice based on information brought to the OCC's attention by the public would be less costly than ordering that a consummated transaction be dissolved following belated discovery of the same information.

In opposition to the proposal one commenter noted simply that the previous OCC disclosure policy had been adopted for valid reasons and should be retained. Information obtained by the public, noted another, would address the competence, experience or integrity of the proposed acquiror and the commenter was concerned that such information may amount to *ad hominem* attacks principally designed to prolong the regulatory process, permitting incumbent management to entrench itself. In addition, the commenter noted that publishing notices of changes in control may increase transaction costs associated with changes in control and may stop such transactions completely, at least for small banks. A third commenter felt the proposed procedure constituted an intrusion into normal business practices, and would erode public confidence by suggesting an impropriety in changes in control. That commenter thought that to announce contemplated changes in control would destroy the confidentiality in the process that presently exists.

These comments are still under review in this Office. As yet, no action has been taken in adopting a final rule.

Question 5

> *Has any thought been given to the use of the civil money penalty provisions of the Financial Institutions Regulatory and Interest Rate Control Act, with appropriate amendments, in connection with violations of the Bank Secrecy Act by financial institutions and their employees? Present delays caused by extended negotiations and record review to determine "willfulness" possibly could be minimized.*

We believe that authority for imposition of civil money penalties properly resides with the Department of Treasury. The approximately 5,000 national banks are only one part of the universe of institutions which fall under Treasury's oversight in the Bank Secrecy Act area. In order to ensure consistency of application against all financial institutions, whether state or federal, the Department of Treasury should continue to have sole authority in this area. Any effort to reduce delays caused by extended negotiations or record reviews to determine "willfulness", should be dealt with within the present BSA enforcement context.

FERNAND J. ST GERMAIN RHODE ISLAND CHAIRMAN

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NINETY-NINTH CONGRESS
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TOBY ROTH WISCONSIN

April 25, 1986

Mr. Francis M. Passarelli
Acting Director
Office of Examination and Supervision
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, D.C. 20552

Dear Mr. Passarelli:

The Subcommittee appreciates your appearance at our hearings last Thursday. Your testimony is of great assistance in our review of the Bank Secrecy Act and other pertinent issues.

There are several questions which the Subcommittee would like to have you answer and which will be submitted for the record. They are as follows:

1. Both Mr. Serino, of the Office of the Comptroller of the Currency, and Mr. Woodard, of the Internal Revenue Service, in their testimony, express support for amending Title 31 of the Bank Secrecy Act via the Administration's Bill (H.R. 2785) to permit the issuance of a summons to a bank, or its employees, for a bank customer's records. This raises some questions about balancing the need for effective investigations of BSA non-compliance with a bank customer's right to privacy.
    a) What criteria do you propose for use of the summons?
    b) How do you intend to prevent this power from abusing the privacy rights of the legitimate customer?

2. Concerning names and businesses which may inappropriately appear on a financial institution's exempt list, presently, how does your agency ensure that appropriate entities are on such lists?

Assuming there is an unqualified name or business on such a list, what types of enforcement action would your agency pursue? At present, would civil or criminal liability be possible against either the financial institution or its exempted customer for inappropriately appearing on such a list?

3. Should the term "monetary instruments" in the Bank Secrecy Act and its regulations be amended to include "postal money orders" in order to include them under the requirements of the Act and its regulations?

4. Has any thought been given to the use of the civil money penalty provisions of the Financial Institutions Regulatory and Interest Rate Control Act, with appropriate amendments, in connection with violations of the Bank Secrecy Act by financial institutions and their employees? Present delays caused by extended negotiations and record review to determine "willfulness" possibly could be minimized.

Again, the Subcommittee is appreciative of your efforts in this area. Please submit your responses to the Subcommittee no later than May 7, 1986.

Sincerely,

Fernand J. St Germain
Chairman

FStG:sTf

Federal Home Loan Bank Board

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

OFFICE OF EXAMINATIONS AND SUPERVISION

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MAY 22 1986
Subcommittee on Financial Institutions

May 22, 1986

Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
U.S. House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

This letter responds to your inquiry of April 25, 1986. The following are our answers to your questions:

1. Question: **Both Mr. Serino, of the Office of the Comptroller of the Currency, and Mr. Woodard, of the Internal Revenue Service, in their testimony, express support for amending Title 31 of the Bank Secrecy Act via the Administration's Bill (H.R. 2785) to permit the issuance of a summons to a bank, or its employees, for a bank customer's records. This raises some questions about balancing the need for effective investigations of BSA non-compliance with a bank customer's right to privacy.**

   a) What criteria do you propose for use of the summons?

   b) How do you intend to prevent this power from abusing the privacy rights of the legitimate customer?

Answer: The Bank Board also supports the Administration's bill (H.R. 2785). The provision referred to in the Subcommittee's question would give the Secretary of the Treasury authority to issue a summons to a financial institution or its employees for a bank customer's records. The bill would limit this authority to the purpose of investigating violations of the Bank Secrecy Act (BSA).

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The Board believes that this limitation is an appropriate criterion for the use of the summons. Providing that an inquiry serves the lawful purpose of investigating possible BSA violations, we believe that the interest of the public in securing compliance with the BSA outweighs the customer's right to the privacy of his records. In this regard, two points must be noted. First, review of customer records by law enforcement officials does not publicize otherwise confidential and legitimate customer records in any way; nor does it alter customer relationships with financial institutions. Thus, there is little potential for abuse of customers' rights to privacy. Second, the bill has built-in safeguards against abuse: it requires the Secretary of the Treasury to refer any enforcement request to the Attorney General, who, in turn, must obtain a court order. Thus, before enforcement could be ordered, two outside entities would examine the consistency of the Secretary's summonses with the requirements of the bill.

2. **Question:** Concerning names and businesses which may inappropriately appear on a financial institution's exempt list, presently, how does your agency ensure that appropriate entities are on such lists?

Assuming there is an unqualified name or business on such a list, what types of enforcement action would your agency pursue? At present, would civil or criminal liability be possible against either the financial institution or its exempted customer for inappropriately appearing on such a list?

Answer: In all regularly scheduled examinations, we require a review of Bank Secrecy Act compliance. Our current procedures for that review contain the following instruction to examiners:

> Obtain a copy of the institution's list of exempt customers. Through a review of this document, determine:
>
> a. Whether its contents conform to the requirements of the regulations (name, address, business, nine-digit Federal taxpayer identification number, reason for exemption, etc.), and that the exemptions appear reasonable.
>
> b. Whether the institution has, in granting exemptions, adhered to its established policy.

We are currently in the process of revising these examination procedures. The new procedures will contain the following instructions:

> The examiner should obtain a copy of the institution's list of exempt customers and review the institution's correspondence with the Internal Revenue Service (IRS) or Department of the Treasury regarding exemptions. Through a review of these documents, the examiners should determine:
>
> a. Whether the contents conform to the requirements of the regulations (name, address, business, nine-digit Federal taxpayer identification number, reason for exemption, etc.), and whether the exemptions appear reasonable.
>
> b. Whether the institution has, in granting exemptions, adhered to its established policy and has documentation to support the limits established. (Lists that appear inordinately long or that contain names of customers whose business size or nature would not ordinarily merit exempt status should be discussed with management of the institution. If management cannot provide adequate explanation and/or supporting documentation, the matter should be reported.)
>
> c. Whether a denial for a special request for exemption from the reporting requirements has been sent to the institution. If so, the examiner should ascertain that currency transaction reports are being filed on that customer when a reportable transaction occurs. If the number of denials is large, the examiner should select a sample to review.

If we find an unqualified name or business on an insured institution's exempt list, we would refer this matter to the Treasury in accordance with the guidelines it has established. See Exhibit 24 to the Report of the Federal Home Loan Bank Board to the Subcommittee (previously submitted).

At present, a willful violation of the Bank Secrecy Act requirements or any regulation thereunder, including requirements for exempt lists provided in 31 C.F.R. § 103.22, can be the subject of civil or criminal penalties under 12 U.S.C. §§ 5321 and 5322. Notwithstanding the above, it appears that a customer who is improperly placed on the exempt list (even if the customer lied to the financial institution) may not be civilly or criminally liable. The customer would not have violated the provisions of 31 C.F.R. § 103.22, or any other provisions of the Bank Secrecy Act or the regulations thereunder because the statute and regulations impose a duty on financial institutions, not on customers. The Bank Board would support legislation that would provide criminal penalties for customers who willfully acted to obtain a position on the exempt list, knowing that position was not permitted by regulations or statute.

3. **Question:** Should the term "monetary instruments" in the Bank Secrecy Act and its regulations be amended to include "postal money orders" in order to include them under the requirements of the Act and its regulations?

Answer: We believe that if postal money orders are being used for money laundering, the Bank Board would support their inclusion in the term "monetary instruments." However, we have no evidence that postal money orders are so used.

4. **Question:** Has any thought been given to the use of the civil money penalty provisions of the Financial Institutions Regulatory and Interest Rate Control Act, with appropriate amendments, in connection with violations of the Bank Secrecy Act by financial institutions and their employees? Present delays caused by extended negotiations and record review to determine "willfulness" possibly could be minimized.

Answer: The Bank Board has authority to assess civil money penalties in very limited situations. The assessment process is a lengthy one requiring a full Administrative Procedure Act hearing if the institution or individual does not consent to the payment of a proposed penalty. Based on our experience, this process appears unlikely to minimize delays occurring under the present system. Moreover, where other authorities — Treasury, Justice, IRS — already have primary responsibility for imposing penalties under the BSA, it does not appear necessary or desirable to duplicate this effort and authority within the financial institution regulatory agencies.

At the hearings before your Subcommittee, we were asked about the average size of money orders sold by the institutions we regulate. Since the Board does not maintain such information, we contacted five Federal Home Loan Banks, who in turn surveyed a sample of institutions. We found a wide range of policies, and have enclosed the results of the survey.

I hope that the information I have provided in this letter is helpful. Please do not hesitate to contact me again if I can be of further assistance.

Sincerely,

Francis Passarelli

Francis M. Passarelli
Acting Director

Enclosure

MONEY ORDER AMOUNT SURVEY

Conducted during the week of May 5, 1986

Five Federal Home Loan Banks each contacted five member institutions and asked: (1) do they have a limit on the size of a money order they will sell, and if there is a limit, what is the maximum dollar amount, and (2) what is the typical size, or range of amounts, of money orders sold.

DISTRICT BANK	MAXIMUM SIZE	TYPICAL SIZE OR RANGE
FHLB of New York		
Institution 1	NONE	NOT KNOWN
Institution 2	$1,000	NOT KNOWN
Institution 3	$1,000	$ 50 average
Institution 4	$ 500	$100 average
Institution 5	$1,000	$250 average
FHLB of Atlanta		
Institution 1	$1,000	$100 - $150
Institution 2	$1,000	$100 - $300
Institution 3	$1,000	$ 50 - $ 60
Institution 4	$1,000	$200 - $250
Institution 5	$1,000	$100 - $200
FHLB of Chicago		
Institution 1	NONE	$ 5 - $100
Institution 2	NONE	$ 5 - $100
Institution 3	$1,000	$ 50 - $100
Institution 4	$1,000	$ 50 - $100
Institution 5	$5,000	$100 - $200
FHLB of Topeka		
Institution 1	$ 250	$ 2 - $250 ($ 50 Av)
Institution 2	$1,000	$ 10 - $1,000 ($250 Av)
Institution 3	$1,000	$ 10 - $1,000 ($400 Av)
Institution 4	$5,000	$100 - $5,000 ($500 Av)
Institution 5	$1,000	$ 3 - $1,000 ($100 Av)
FHLB of San Francisco		
Institution 1	NONE	$ 300 - $ 400
Institution 2 (institution says the large money orders are bought by customers cashing in CDs and transferring funds to other institutions)	NONE	$5,000 - $20,000
Institution 3	$1,000	$5 - $ 100
Institution 4	$1,000	$5 - $1,000
Institution 5	$3,000	$5 - $ 100

FERNAND J. ST GERMAIN, RHODE ISLAND, CHAIRMAN

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TOBY ROTH, WISCONSIN

April 25, 1986

Mr. Percy P. Woodard, Jr.
Assistant Commissioner (Examination)
Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224

Dear Mr. Woodard:

The Subcommittee appreciates your appearance at our hearings last Thursday. Your testimony is of great assistance in our review of the Bank Secrecy Act and other pertinent issues.

There are several questions which the Subcommittee would like to have you answer and which will be submitted for the record. They are as follows:

1. Both you and Mr. Serino, of the Office of the Comptroller of the Currency, in your testimony, express support for amending Title 31 of the Bank Secrecy Act via the Administration's Bill (H.R. 2785) to permit the issuance of a summons to a bank, or its employees, for a bank customer's records. This raises some questions about balancing the need for effective investigations of BSA non-compliance with a bank customer's right to privacy.
    a) What criteria do you propose for use of the summons?
    b) How do you intend to prevent this power from abusing the privacy rights of the legitimate customer?

2. Concerning names and businesses which may inappropriately appear on a financial institution's exempt list, presently, how does your agency ensure that appropriate entities are on such lists? Assuming there is an unqualified name or business

on such a list, what types of enforcement action would your agency pursue? At present, would civil or criminal liability be possible against either the financial institution or its exempted customer for inappropriately appearing on such a list?

3. Should the term "monetary instruments" in the Bank Secrecy Act and its regulations be amended to include "postal money orders" in order to include them under the requirements of the Act and its regulations?

4. Has any thought been given to the use of the civil money penalty provisions of the Financial Institution Regulatory and Interest Rate Control Act, with appropriate amendments, in connection with violations of the Bank Secrecy Act by financial institutions and their employees? Present delays caused by extended negotiations and record review to determine "willfulness" possibly could be minimized.

5. In your testimony, you explained what financial institutions were under the Internal Revenue Service's (Examination) jurisdiction for Bank Secrecy Act purposes. You included in your list, "Licensed entities that send or transmit funds abroad for others". Please describe these "licensed entities", including examples and an explanation of who licenses these entities.

Again, the Subcommittee is appreciative of your efforts in this area. Please submit your responses to the Subcommittee no later than May 7, 1986.

Sincerely,

Fernand J. St Germain
Chairman

FStG:sTE

Washington, DC 20224

Examination

JUN 17 1986

The Honorable Fernand J. St Germain
Chairman, Subcommittee on Financial Institutions
Supervision, Regulation and Insurance of the
Committee on Banking, Finance, and Urban Affairs
Rayburn House Office Building, Room B-303
Washington, DC 20515-6051

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Subcommittee on Financial Institutions

Dear Mr. Chairman:

In your letter to Mr. Percy Woodard, Jr. of April 25, 1986, you presented five questions in connection with his testimony of April 17, 1986. The following is our response to your questions.

Question 1.

> Both you and Mr. Serino, of the Office of the Comptroller of the Currency, in your testimony, express support for amending Title 31 of the Bank Secrecy Act via the Administration's Bill (H.R. 2785) to permit the issuance of a summons to a bank, or its employees, for a bank customer's records. This raises some questions about balancing the need for effective investigations of BSA non-compliance with a bank customer's right to privacy.
> a) What criteria do you propose for use of the summons?
> b) How do you intend to prevent this power from abusing the privacy rights of the legitimate customer?

Response:

The Internal Revenue Service does not have authority under the Bank Secrecy Act (BSA) to issue a summons to those financial institutions under its jurisdiction. Summons authority is necessary for two situations. The most common is the instance where a financial institution is cooperative, but requests a summons as a means of protecting itself from possible suits by its customers. The other type of situation is where an institution declines to cooperate by providing us with access to the appropriate books and records in order to determine if it is complying with the reporting and recordkeeping requirements of the BSA. These situations would be corrected by providing the summons authority proposed in H.R. 2785 and 2786.

The summons authority would permit the examination of records and testimony for the purposes of investigating BSA violations. The records of the customers would be accessible solely for the purposes of determining the institution's compliance with the BSA. The incidental review of individual customers would be analogous to the review of such records by bank examiners; the focus is on the actions of the institution, not the customer.

While we have not drafted specific written criteria, income tax compliance activities would have to be generated from filed CTRs. If a financial institution's records were then desired for a tax investigation relating to a particular customer, a summons would have to be served under the provision of Title 26 to gain access to the records.

Question 2.

> Concerning names and businesses which may inappropriately appear on a financial institution's exempt list, presently, how does your agency ensure that appropriate entities are on such lists? Assuming there is an unqualified name or business on such a list, what types of enforcement action would your agency pursue? At present, would civil or criminal liability be possible against either the financial institution or its exempted customer for inappropriately appearing on such a list.

Response:

The IRS monitors the propriety of exemptions by requesting and reviewing exemption lists from financial institutions (some unsolicited lists are also received). We are also assisted by the review functions performed by other regulatory federal agencies that conduct compliance checks. The following is a summary of what the Service does in the way of ensuring that listed exemptions are proper.

The Service has the authority to direct banks to remove entities from the list and to file CTRs for the preceding 5-year statutory period. Where an unqualified business is found on an exemption list, we would direct removal and, if useful, require the filing of delinquent CTRs. If warranted, a referral to our Criminal Investigation function would be made. Our Criminal Investigation function has the authority to conduct investigations of criminal violation(s) of any bank.

Also, other supervisory agencies in conjunction with their compliance checks can direct a bank to remove an entity from the exemption list. In these situations, the bank is usually directed to apply for a special exemption and request the Service's advice on the need to file delinquent CTRs.

During the review of an exemption list, we look for entities that are clearly outside of the regulatory definitions, such as automobile, boat, and aircraft dealers. We review for incomplete data required by the regulations, such as tax identification and account numbers. We ensure that personal accounts are not listed for exemption. We evaluate the dollar limitations for reasonableness. We contact the banks, where warranted, for information to complete the determination. Where warranted, we will request a recent 2-month summary of deposit and withdrawal activity, and the amount of activity in $100 bills. A determination is then made to either accept, remove, or modify an exemption. Sometimes, we will have to direct the banks to remove a customer(s) from the exemption list and file CTRs for both prior and future transactions. Examples of modification might include a reduction of the dollar limitations, or qualifying the exemption to accommodate weekend deposits or seasonal fluctuations.

At present, civil penalties are under the jurisdiction of the Department of Treasury. Where the evidence demonstrates that the bank, and/or its unqualified customer, knowingly, used the exemption list for the purpose of circumventing the financial reporting requirements, IRS Criminal Investigation can recommend prosecution of the financial institution under 31 U.S.C. 5322 for failing to file a CTR and/or of the customer (under 18 U.S.C. 2(b) in conjunction with 31 U.S.C. 5322 or 18 U.S.C. 1001) for causing the institution to fail to file a CTR. However, not all judicial circuits agree that the customer is subject to prosecution. See United States v. Dela Espriella, 781 F. 2nd 1432 (9th Cir. 1986). At the present time, the reporting requirement and Title 31 penalties are directed at the bank. We do not have direct Title 31 civil sanctions to impose on customers who are improperly on the exemption list.

Question 3.

> Should the term "monetary instruments" in the Bank Secrecy Act and its regulations be amended to include "postal money orders" in order to include them under the requirements of the Act and its regulations.

Response:

We understand that Treasury will be responding directly to you on this question.

The Honorable Fernand J. St Germain

Question 4.

> Has any thought been given to the use of the civil money penalty provisions of the Financial Institution Regulatory and Interest Rate Control Act, with appropriate amendments, in connection with violations of the Bank Secrecy Act by financial institutions and their employees? Present delays caused by extended negotiations and record review to determine "willfulness" possibly could be minimized.

Response:

We understand that Treasury will be responding directly to you on this question.

Question 5.

> In your testimony, you explained what financial institutions were under the Internal Revenue Service's (Examination) jurisdiction for Bank Secrecy Act purposes. You included in your list, "Licensed entities that send or transmit funds abroad for others". Please describe these "licensed entities", including examples and an explanation of who licenses these entities.

Response:

By "licensed" we mean that the entity is licensed by a state or federal regulatory agency, such as a State Banking Commission. Although Customs has the compliance jurisdiction for funds being sent or transmitted abroad, IRS also shares in this responsibility. For instance, if a foreign currency exchange dealer sends funds outside the U.S. via an air courier service, the IRS is responsible for ensuring compliance by the dealer relative to the filing of Forms 4789 (CTR) and 4790 (CMIR). In general, a foreign currency exchange dealer is licensed by a State Banking Commission or other state regulatory agency. It should be noted that the term "Licensed entities ...." is from 31 CFR 103.11(e)(5).

I hope this information is of assistance to your review of the Service's role in connection with the Bank Secrecy Act.

Sincerely yours,

Frederic P. Williams

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TAX EVASION, DRUG TRAFFICKING, AND MONEY LAUNDERING AS THEY INVOLVE FINANCIAL INSTITUTIONS

WEDNESDAY, APRIL 23, 1986

House of Representatives,
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance,
Committee on Banking, Finance and Urban Affairs,
Washington, DC.

The subcommittee met, pursuant to call, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of the subcommittee) presiding.

Present: Chairman St Germain; Representatives Annunzio, Barnard, Kaptur, Wylie, McKinney, McCollum, and Wortley.

Also present: Representative Torres of the full committee.

Chairman **St Germain**. The subcommittee will come to order.

Today, the subcommittee continues its hearings on the abuse of financial institutions by tax evaders, drug traffickers, and money launderers to facilitate their illegal activities.

Last week, the subcommittee heard from, among others, a former money launderer, or "smurf," now a witness for the Federal Government, who told us how easy it was to deceive banks into believing that reporting requirements under the Bank Secrecy Act were not applicable.

This witness laundered as much as $100,000 per day without any questions asked, apparently with no suspicions aroused, and arguably, although there are differing opinions among the circuit courts, without breaking the law.

I am sure that my colleagues on this subcommittee agree with me that this preposterous activity must be put to an end promptly, and that Congress should provide to the courts a clear statement of intent that will assist law enforcement in this regard.

We have been told that while the Bank Secrecy Act has been an effective tool in exposing criminals who use this Nation's financial institutions to facilitate their crimes, this tool, in itself, is not enough.

It is argued that a statute creating a crime for money laundering must be enacted. The subcommittee will examine this contention and will consider other proposals within our jurisdiction that would conceivably strengthen the current provisions of the Bank Secrecy Act.

Our first witness is Stephen S. Trott, Assistant Attorney General, Criminal Division, Department of Justice, who will give us the benefit of the Department's views on the various money-laundering bills, including the administration's, which have been referred to the Banking Committee.

The Chair would note that the subcommittee heard last week from Assistant Secretary Keating of the Treasury Department, who also appeared as a spokesman for the administration's views.

Our second witness is Alwin C. Coward, Acting Deputy Assistant Administrator for Intelligence, Drug Enforcement Administration, Department of Justice. This is DEA's first appearance before the subcommittee.

Not only will we receive a briefing of that agency's functions, but, most importantly, we will be advised as to how it coordinates its drug enforcement activities with other appropriate agencies of the Federal Government.

We are also looking forward to hearing how the DEA uses the financial intelligence and other data available to it to carry out its mission.

Mr. Trott and Mr. Coward, welcome to the subcommittee. Prior to your beginning, I will call upon our distinguished ranking minority member, Mr. Wylie, for a brief statement.

Mr. **Wylie**. I want to also welcome our witnesses here this morning, and I know that they will give us valuable testimony. In testimony last week before this subcommittee, and confirmed by Assistant Attorney General Trott, in his testimony today, we learned that the drug trade generates an estimated $80 to $90 billion a year.

This astounding amount of unreported income is then laundered through financial institutions and other entities into legitimate-looking funds.

While the financial institution regulators and the IRS are beefing up their training enforcement and investigations in the area of money laundering and unreported earnings, we need to keep in mind the major source of these funds, and that is drug sales.

We can do everything within our power to crack down on money laundering. Yet, it won't decrease the availability of illegal drugs, unless there is cooperation between regulatory agencies, the Internal Revenue Service, and law enforcement officials.

Money laundering goes far beyond the failure to meet reporting requirements. Money laundering in itself masks other crimes. This $90 billion figure representing the amount of money moving through our economy attributed directly to drug trafficking is staggering.

Money laundering is easy. Stopping it is hard. We have to use all reasonable means at our disposal to help stop this, and I am sure today's witnesses from the Justice Department will enlighten us further on this issue, and I do look forward to your testimony.

Thank you, Mr. Chairman.

Chairman **St Germain**. Mr. Trott and Mr. Coward, we will put your entire statements in the record. You may now proceed.

STATEMENT OF STEPHEN S. TROTT, ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF JUSTICE, ACCOMPANIED BY CHARLES S. SAPHOS, CHIEF, NARCOTIC AND DANGEROUS DRUG SECTION

Mr. TROTT. I am pleased to be here today to present the views——

Chairman ST GERMAIN. We have a problem with these mikes, you know, Gramm-Rudman, so please get a little closer.

Mr. TROTT. I am pleased to be here today to present the views of the Department of Justice. I am accompanied by Charles Saphos, Chief, Narcotic and Dangerous Drug Section, Criminal Division, and he was responsible for the case shown in the photograph to your left.

The complexity of the problem can be gauged in one sense by the sheer number of bills that have been introduced on this subject, many of which are now before this committee, and upon which I will touch in a moment.

As you know, Mr. Chairman, the bill that the administration supports is H.R. 2785, which was prepared by the Departments of Justice and the Treasury working together. It is the type of comprehensive approach that we believe is needed in this area.

And I want to thank you for introducing it, so it could be considered. The bill sets out a number of new offenses, including a new offense aimed specifically at money laundering, and also amends the Currency and Foreign Transactions Reporting Act, and the Right to Financial Privacy Act.

The administration had the advantage of reviewing the legislative proposals drafted by the President's Commission on Organized Crime when we prepared what is now H.R. 2785.

Like the Commission, we concluded that what is most urgently needed is a new offense dealing specifically with money laundering. The Bank Secrecy Act, which requires that various monetary transactions be reported on forms, and which punishes the failure to do so truthfully, is no longer adequate by itself.

A new provision must be added to title 18 of the United States Code making it an offense to conduct a transaction involving monetary instruments, or the wire transfer of funds if the transaction affects interstate or foreign commerce, or is conducted through a financial institution, the activities of which affect such commerce, provided that the Government can show either of the following:

First, that the person acted with the intent to promote, manage, establish, carry on, or facilitate an unlawful activity—defined as a State or Federal felony—or, second, that the person knew or acted with reckless disregard of the fact that the monetary instruments represent the proceeds of, or are derived from the proceeds of, an unlawful activity.

Mr. Chairman, there is an analogy here that is quite helpful. Up until the late 1960's, the Federal Government and law enforcement in general were attempting to cope with racketeering activity throughout the United States by using individual statutes to go against parts of racketeering.

If mobsters committed an assault, we charged them with an assault, and if they bribed somebody, we'd charge them with bribery, if they murdered somebody, we charged them with murder; and we were nibbling away at the edges, and, finally, Congress woke up and said what is needed is a crime, prohibiting racketeering, and the Rico statute was born.

And as everybody knows, from following the cases we have been reading, has been a thermonuclear device ending up in putting most of the major mob leaders in the United States now in Federal Court——

Chairman ST GERMAIN. Did you write this testimony yourself?

Mr. TROTT. Excuse me?

Chairman ST GERMAIN. You know, what you just said: "Finally, the Congress woke up." What do you mean by that?

Mr. TROTT. What I mean was——

Chairman ST GERMAIN. I want you to explain that phrase. I don't particularly like it. It is not that easy to enact legislation. I want to know what you mean by the phrase: "Finally, the Congress woke up."

Mr. TROTT. I was attempting to describe the process by which we all woke up, including law enforcement.

Chairman ST GERMAIN. You said: "Finally, the Congress woke up." What did you mean by that?

Mr. TROTT. Exactly what I said, and that is finally, we realized that we were nibbling around the edges——

Chairman ST GERMAIN. You mean the Congress was asleep; the Congress didn't know anything, or do you mean what I think you should mean; and that is, that the legislative process, and enacting some of these laws, is not all that easy, and that there are many difficulties involved, including the hurdles which proponents of legislation have to go over?

Maybe you meant to say that finally, the Congress was able to enact and to achieve, and to negotiate legislation. I don't like the phrase: "Finally, the Congress woke up."

Mr. TROTT. You are probably correct. I understand what you are getting at, and I apologize for using that phraseology. I meant to say Congress realized that a new approach was needed to a problem. That is all I meant by "woke up," I meant "realized"; and I withdraw that language, if you find it offensive, Mr. Chairman.

Law enforcement simply recognized, as did Congress, that a new overreaching approach was necessary to this, and the Rico statute was born.

We need the equivalent today with respect to money laundering. Instead of using the Bank Secrecy Act, a money-laundering statute as such is necessary to describe the conduct involved and make the conduct itself criminal.

That is my point.

This is the subject of the new money-laundering offense in H.R. 2785. It covers not only the person who deposits the cash, that has just arrived from an unlawful sale of drugs in a bank or uses it to buy a new car, but also the bank employee or car salesman who participated in the transaction by accepting the money, if it can be proven that the person knew or acted in reckless disregard of the fact that the money involved was derived from unlawful activity.

We think coverage of these persons is very important. These people, and in particular the employees of banks who knowingly or recklessly help criminals dispose of the fruits of their crimes, are a vital part of the world of the drug dealers.

Drug dealers are in business for the money and corrupt or deliberately reckless bank employees allow them to get their money in a form they can use. They are as deserving of punishment as the drug dealer who brings them his ill-gotten cash or other monetary instruments derived from his cash.

We realize that many persons are concerned about the money-laundering offense's coverage of a person who cannot be shown to have actual knowledge that the money he handles in a transaction was derived from a crime but who acts in reckless disregard of the fact that it was.

In my prepared statement, I give several examples, some actual and some hypothetical, which show that often people like bankers and lawyers who take huge sums of cash with no questions asked are ignoring an obvious substantial risk that the money involved is derived from a crime.

To ignore that risk is to act in reckless disregard of the fact that the money is "dirty." Many times a banker or lawyer knows full well from the nature of the transaction and the surrounding circumstances that the money he is being handed was obtained illegally. He just does not know what particular crime produced it.

Without a reckless disregard standard, these people cannot be prosecuted and they will continue to profit from making themselves willfully blind to the obvious. It is a correct description of the obvious: See no evil, ask no questions, and act in gross disregard of what would be the ordinary standard in the industry today.

In addition to the new money laundering offense, H.R. 2785 adds other new offenses to title XVIII. A new criminal facilitation offense is set out. It would make one who knowingly facilitates the commission of a Federal crime by another person by providing substantial assistance guilty as a principal.

I would hope, in prosecuting people who took small denomination bills, that knew they are derived from street sales of drugs and, for a fee, changing them into more easily transportable $100 bills, or other bills or larger denominations.

H.R. 2785 also sets out a new offense of receiving the proceeds of a Federal felony, like the money derived from a cocaine sale, and a new offense of bringing into the United States any money or other property obtained in connection with the violation of the law of a foreign country proscribing narcotics trafficking.

This offense is intended to reach foreign drug traffickers who would look to the United States, and particularly its banking system, as a place in which to invest their illegal profits.

In addition to these offenses, H.R. 2785 makes amendments to two banking statutes that are within the committee's jurisdiction.

Section 3 of the bill amends the RFPA to define and clarify further the extent to which financial institutions may cooperate with Federal law enforcement authorities in providing information which is relevant to proving criminal activity.

Most of these amendments are variations of recommendations made by the President's Commission on Organized Crime.

Of greatest significance is subsection 3(a), which states that nothing in the RFPA shall apply when a financial institution provides financial records to a Federal agency which the financial institution believes may be relevant to crimes by or against the institution or a financial institution supervisory agency, violations of the Bank Secrecy Act in title XXXI, violations of the proposed new money-laundering statute, and certain serious drug felonies.

The effect of this amendment would be simply to allow a bank to fulfill its civic duty and provide information which it has reason to believe may be relevant to one of these very serious offenses without risking civil liability under the RFPA or having to notify the customer of its cooperation.

Section 3 also provides for preemption of this field, thus avoiding the possibility that a bank employee might incur civil or criminal liability under a more strict State bank secrecy law for cooperating with Federal law enforcement authorities.

Section 5 of H.R. 2785 amends the Bank Secrecy Act to give the Secretary of the Treasury summons authority for financial institution witnesses and documents in connection with Bank Secrecy Act violations.

Such authority was another recommendation of the President's Commission on Organized Crime. It would allow the Secretary to summon a financial institution employee who may have knowledge of a violation of one of the recordkeeping or reporting requirements of the BSA and require the production of relevant documents.

We think authority is essential to investigate civil violations of the BSA and to assess an appropriate civil penalty once a violation is discovered.

Briefly, let me now discuss some of the other bills before the committee, starting with H.R. 1367 and H.R. 1945. These bills set out the new money laundering offense recommended by the President's Commission on Organized Crime.

We examined that approach and, although the money-laundering offense in H.R. 2785 is derived from it, we think there are problems with H.R. 1367 and 1945.

First, they would only reach money laundering through financial institutions. That is simply too restrictive and invites money launderers to go every place else in the country, and escape exactly what this Congress intends to set forth.

It is too restrictive and would not reach money laundering by such means as buying out legitimate businesses or purchasing jewelry for resale.

Second, H.R. 1367 and 1945 would punish one who was merely negligent in engaging in a transaction involving the proceeds of a crime. This is much broader than a reckless disregard standard and, in this context, is inappropriate for criminal liability.

Third, these bills only cover money laundering derived from some Federal felonies. They would not, for example, cover money laundering derived from espionage.

Fourth, these other bills would not reach money laundering through wire transfers. H.R. 2785, by contrast, covers wire transfers. That is important in light of such a means of moving money to and from offshore banks.

H.R. 1367 and 1945 both contain provisions giving the Secretary of the Treasury summons authority over certain bank records and personnel. They are similar to the summons authority in section 5 of H.R. 2785, but not identical.

For example, H.R. 1367 and 1945 would allow Treasury to summons records for both criminal and civil investigations. We think this authority should be limited to civil matters. Moreover, H.R. 1367 provides that Treasury may not delegate its summons authority.

As Mr. Keating noted in his testimony last week, Treasury has delegated Bank Secrecy Act enforcement authority to a number of agencies like the Comptroller of the Currency and delegating summons authority is a practical necessity in everyday matters of conducting law enforcement activities.

H.R. 2785 contains what we think are fully adequate restraints on the use of summons authority by providing that a supervisory level official of an organization that enforces the Bank Secrecy Act must approve a summons. An agent or bank examiner in the field could not issue one.

Turning now to H.R. 1474, that bill sets out a new money laundering offense that has many of the same problems as are in the offense in H.R. 1367 and H.R. 1945. It would be limited to laundering money derived from many, but not all, Federal felonies.

The laundering would have to be done through a financial transaction at a financial institution and would thus not reach money laundering through other methods.

In addition, the definition of "financial transaction" is too narrow. It would exclude such things as purchasing bank stock and placing funds in escrow as collateral for a loan.

I would also note that sections 3 through 5 of H.R. 1474 contain amendments to the Bank Secrecy Act which are of primary concern to Treasury.

Let me say, however, that Treasury feels section 3, which would require the Secretary to approve every Bank Secrecy Act reporting exemption, would be unduly burdensome.

As you know, current regulations allow the banks to exempt certain cash deposits from retail businesses from the reporting requirements. If section 3 would be burdensome for Treasury, section 4 of H.R. 1474 would be terribly burdensome for banks.

It would require the reporting of every outgoing international wire transfer. That would require financial institutions to bury Treasury in a mountain of reports, most of which would be useless.

Moreover, Treasury already has the authority to require the reporting of wire transfers and can order the reporting of classes of transfers it deems useful.

Before leaving H.R. 1474, let me mention section 6. That section deals with the problem of persons about to board international flights with large amounts of cash that they had not declared, as required under the Currency and Foreign Transactions Reporting Act.

Before 1984, 31 United States Code 5316(a) punished one who transports such cash or other types of monetary instruments. There was no attempt provision and some courts had held that no violation had occurred until the person was on the verge of boarding the plane, at which time apprehension was difficult.

The Comprehensive Crime Control Act of 1984 added an attempt provision to 31 United States Code 5316(a), thus resolving this problem, so section 6 of H.R. 1474 is now unnecessary.

Turning now to H.R. 4573, introduced by Congressman Pickle, it is aimed at overcoming problems of smurfing, or structuring monetary transactions by breaking up what is essentially one transaction into a series of smaller transactions, to avoid reporting requirements under the Bank Secrecy Act.

In my prepared statement, I set out a number of recent cases that have severely hampered our ability to attack smurfing. Clever defendants seem to be able to stay one step ahead of the Treasury and Justice and the Bank Secrecy Act.

Justice and Treasury are working closely to close some of these regulatory loopholes, but there is just a little bit that can be done by regulation.

Legislation is clearly necessary. H.R. 4573 also deals with smurfing problems by prohibiting the structuring of financial transactions for the purpose of evading reporting requirements.

We endorse this bill as it relates to the structuring problem, but let me emphasize that we do not see it is a substitute for H.R. 2785. Filing reports on monetary transactions are important and at the moment changes in these reporting requirements are needed.

But punishing people who fail to file reports to live up to these requirements, we are approaching the problem in a very indirect way.

Turning to H.R. 4280, I note that, among other things, it would amend the Bank Secrecy Act to eliminate the discretion presently granted to Treasury to determine when currency transaction reports must be filed by financial institutions and persons who participate in transactions with financial institutions.

Presently, 31 United States Code 5313 provides that they must be filed on an amount, denomination, or amount and denomination, or under circumstances the Secretary prescribes by regulation. The present regulation sets the amount at $10,000 or more.

However, the Secretary could lower that amount, and several ideas are presently being considered under which such a reduction could to be used to deal with the structuring problem I talked about earlier.

H.R. 4280 would eliminate this possibility by setting the amount above which a CTR must be filed at $10,000 or more. Consequently, we oppose this bill.

Mr. Chairman, rather than continue to take up your valuable time with detailed references to differences in these bills, we would be willing to answer any questions you might have on our statement or anything else we might be able to help you with.

[The prepared statement of Mr. Trott on behalf of the Department of Justice can be found in the appendix.]

Chairman **St Germain**. Now we will hear from Mr. Coward.

STATEMENT OF ALWIN C. COWARD, ACTING DEPUTY ASSISTANT ADMINISTRATOR FOR INTELLIGENCE, DRUG ENFORCEMENT ADMINISTRATION, DEPARTMENT OF JUSTICE

Mr. **Coward**. Thank you, Mr. Chairman, members of the subcommittee, for the opportunity to appear here today.

I would like to take a few moments since DEA has not had the opportunity to appear here before, to briefly acquaint you with our agency, what we do, and a little bit about how we do it, and then get into the money laundering operation.

DEA is a fairly small agency with a large mandate. We have three principal functions. No. 1, among those is enforcement of the Controlled Substances Act, and we do that with the FBI, and with other agencies. DEA is also responsible for maintaining an intelligence network, programs which service the Federal enforcement community, State and local communities, and to a large degree supports our counterparts overseas. Third, we have a diversion investigative arm which is responsible for the investigation and registration of licit producers of drugs, and the diversion from those licit producers to illicit markets.

Our agent strength is 2,500 agents. We are spread fairly thin, 120 offices in the United States, and offices in some 42 countries overseas.

We stay busy.

Chairman **St Germain**. Mr. Coward, you state that your work force is now at some 2,500?

Mr. **Coward**. Another roughly 2,000 support personnel.

Chairman **St Germain**. 4,600. What was it 10 years ago, and 5 years ago?

Mr. **Coward**. I don't have the exact figure, but it was substantially less.

Chairman **St Germain**. Well, let me rephrase the question.

Has your work force increased, remained stable, or decreased in the last 5 years?

Mr. **Coward**. Gradually increased, not a remarkable increase in the last 5 years, but in the hundreds of agents, at least.

Chairman **St Germain**. Now, did this increase occur along with or concommitant with increased duties, or have the mandates—has your mandate remained constant?

Mr. **Coward**. Our mandate has been fairly constant. It is just that the drug trafficking has continued to increase because of the——

Chairman **St Germain**. This last line then, drug trafficking would have increased in the past couple—during a 5-year period?

Mr. **Coward**. Certainly.

Chairman **St Germain**. If you had a graph, by what percentage would drug trafficking have increased in the past 5 years, for instance?

Mr. **Coward**. That would be difficult to graph, sir, because there is no way we can make an accurate statement as to the level of the drug trafficking.

We know our efforts, and we know what they have produced.

Chairman ST GERMAIN. Last time: Has your increase—or has the increase in your work force paralleled what you feel the increase in drug trafficking has been?

Mr. COWARD. In that they have both escalated, yes, sir. Whether or not it has been pro rata, I am not sure, because we don't have an accurate handle on it.

Chairman ST GERMAIN. You don't have a personal opinion?

Mr. COWARD. The drug trafficking is endless. We need all the people we can get in order to attack the problem.

Chairman ST GERMAIN. Your work force has increased in the past 2 or 3 years by how many hundred?

Mr. COWARD. Several.

Chairman ST GERMAIN. 1,000?

Mr. COWARD. No, sir.

Chairman ST GERMAIN. 500?

Mr. COWARD. Probably, or slightly less.

Chairman ST GERMAIN. Slightly less?

Mr. COWARD. Yes, sir.

Chairman ST GERMAIN. Thank you.

Mr. COWARD. In any event, our 2,500 agents do stay busy. Last year, we made 15,000 arrests, and we seized 300 or so clandestine laboratories in this country. We seized 38,000 pounds of cocaine, 1.6 million pounds of marijuana, 980 pounds of heroin, and we seized more than $250 million in trafficker assets, so we do stay busy.

In addition to these principal programs, DEA assists and supports other Federal, State, and local agencies and foreign governments with training, crop eradication programs, and other nonenforcement programs.

We are encouraging increased forfeiture legislation among all the jurisdictions we work with, because it is a good technique to attact the drug trafficking problem.

Overseas, we work under the direction of the Secretary of State and U.S. Ambassadors. Also overseas, in our role we try to deal with groups of nations as much as possible.

We work very closely with Interpol, the United Nations, regional geographic organizations, and principally with our counterparts, the law enforcement officials of those countries. We seem to share a common bond, and we work very well on a working level basis.

Today's drug traffickers are truly international entrepreneurs and, because of this, international cooperating in investigating cases, obtaining evidence, and coordination prosecutions is crucial to DEA and Justice Department enforcement efforts.

DEA has encouraged bilateral mutual legal assistance treaties, other bilateral agreements, and a number of other cooperative arrangements to provide us with better intelligence and with evidence which might otherwise be unavailable because of bank secrecy laws.

Most of our overseas work is man-to-man, police officer-to-police officer. We are in the trenches with them.

As you requested, I would like now to expand a bit on the subject of money laundering of drug profits and the Federal Government's seizure and forfeiture of drug trafficker assets.

Financial investigations leading to the seizure and forfeiture of assets are a crucial part of narcotics enforcement. The Comprehensive Crime Control Act of 1984 makes seizure and forfeiture of the profits and assets generated by trafficking in narcotics important weapons in the Government's war on drugs.

Because of the enormous profits being reaped by drug traffickers today, the Drug Enforcement Administration has greatly increased its emphasis on programs to separate traffickers from their ill-gotten gains.

Experience has shown that regardless of the size of an illegal drug operation, the arrest of an organization's members, or even its leaders, will not necessarily put the operation out of business.

There are always associates, lieutenants, or family members ready to continue operations while the boss is in jail; and the boss may even be calling the shots from behind bars.

We have found, though, that when we take away the assets from an organization, we have virtually rendered it impotent. They have to find new routes. If we can eliminate the traffickers, if we are able to identify and successfuly prosecute them, and then take away their assets, the chances for having success are far greater.

We are no longer limited to taking vehicles, as we were for many years. We take cars, airplanes, bank accounts, race horses, ongoing businesses.

We work closely with the Marshal Service, who now has the responsibility for running the Asset Forfeiture Program within the Department of Justice. They handle the assets during pendency of the forfeiture proceedings, until the property is sold.

We work with FBI, IRS, Marshal Service and others in initial investigations and in the tracking of assets.

IRS is working on violations of the tax laws at the same time, and we have found that this cooperative arrangement is to everyone's benefit.

Frequently, we will work together to make a case against the same organization, and in those instances, if for whatever reason, the civil forefeiture under title XXI is not successful, the IRS is able to come behind with the tax statute and still keep the property from going back into the hands of the traffickers and their organizations.

In 1985, DEA seized cash and other property valued in excess of $250 million, and we plan to do more. We are putting considerably more emphasis on this program. We are forming teams of agents in each of our divisions; we currently have three in place and four more are being formed as we speak.

We would hope that the rest of our field divisions have teams in place soon. The prototype effort in San Diego in the last several years has shown astounding results with a far greater percentage of trafficker assets being seized and forfeited.

We are trying to proliferate this program now. These agents are specially trained. They spend a great deal of time developing the expertise necessary to track these assets, and to assist the U.S. attorneys in preparing for the forfeiture.

While DEA is pleased with the progress of its Asset Removal Program, we are anticipating our success is going to create additional problems. As we become more successful in seizing trafficker assets we can only suspect the traffickers will become more sophisticated in laundering the proceeds of their enterprises, in trying to put them outside our reach. As we find new methods being employed we have to develop techniques to counter these.

The pending legislation, H.R. 2785, will certainly go a long way to stopping these new techniques. In the past, without any specific legislation directed at money laundering, there were certain people within an organization which we simply were not able to get, because they were insulated from the drugs.

It was difficult to draw the nexus and although we knew they were involved in the laundering of the money. This legislation will solve that problem. Likewise, to facilitation part of the statute, or of the bill, will allow us to get a better handle on the smurfing situation, and on some of the other folks that handle these transactions for the traffickers.

Again, they have generally been unavailable to us under other statutes. We are anxious, not because the smurfs are big time drug traffickers—frequently, they are simply low-paid lackeys doing the work for the traffickers—but if there is a criminal charge to which they are accountable, not only are we able to prevent them from continuing their activities, but they might also become more willing witnesses against higher-ups in the organization.

We look forward to that provision. Another part would be the clarification of the ability of the banks to provide information to us in the way of investigative leads when they notice suspicious activity.

There is some uncertainty on the part of bankers as to what they can and cannot provide to us under the current legislation. Clarifying that would be useful.

The techniques of money laundering, I am sure you have heard about before, and there are as many as there are drug traffickers. They may be very simple, such as exchanging lots of little bills for few small ones or cashier's checks, by using smurfs.

In some cases, they use dozens and dozens of shell corporations, brokerage accounts and all manner of financial transactions.

One of the examples which I am sure you heard of before, is the *Orozco* case. He was convicted along with several others in May 1983 on drug conspiracy charges. Over a 4-year period he deposited $150 million in cash in some 18 bank and currency exchange accounts, mostly in New York City, and then transferred these funds to other accounts in the United States, Panama, and the Cayman Islands.

Chairman **St Germain**. Regarding the *Orozco* case, did you say he was convicted?

Mr. **Coward**. Yes, sir, in May 1983.

Chairman **St Germain**. He had laundered how much money?

Mr. **Coward**. $150 million over a 4-year period.

Chairman **St Germain**. How much of that was recovered?

Mr. **Coward**. I am sorry, I don't know the figure.

Chairman **St Germain**. Do you know what his sentence was?

Mr. **Coward**. No, I am sorry, I don't have it.

Mr. **Trott**. Mr. Chairman, we can provide that for the record, if you wish.

Chairman **St Germain**. You don't have a ballpark figure?

Mr. **Trott**. No.

Chairman **St Germain**. Was it 10 years?

Mr. TROTT. I don't know.

Mr. COWARD. In a 1983 Miami conspiracy case, DEA arrested 36 individuals, 2 of whom were bank officials, a vice president of the Great American Bank and a vice president of the Bank of Miami.

The defendants had negotiated with undercover DEA agents to recruit clients for money laundering and investment services. Approximately $45 million in drug money had been laundered through these banks for various cocaine traffickers.

In another case, Isaac Kattan was arrested by DEA in February 1981. He had on him at the time $18,000 in cash and $365,000 in checks. The next day, search warrants were executed and a bank account worth almost $1 million was seized, along with an international telex machine, several money counting machines, and thousands of financial documents.

Analysis of the seized documents showed that Kattan's organization had handled gross proceeds estimated at $200 to $250 million per year. During the 4-month period prior to Kattan's arrest, his money couriers transported $61 million in cash to a brokerage firm.

This money was the proceeds from cocaine sales in New York, Los Angeles, and Miami, and movement of the funds was facilitated by Kattan's travel agency in Cali, Colombia, which was also licensed to conduct business as a money exchange.

These examples are dated for obvious reasons. We have more current examples. The cases are still open, however.

Our agents, acting undercover, are being approached on a routine basis by traffickers who are looking to launder enormous sums of money. Traffickers have claimed to have as much as $200 million to launder and we can easily suspect that if they have $200 million to place with one money launderer, there is even more being handled by others. Rarely do these people put all of their eggs in one basket.

To cope with these approaches to our undercover agents, DEA has developed techniques designed to ultimately forfeit as much as possible of these moneys to the Government. However, it would be inappropriate to discuss the details of these investigative approaches in open session.

One thing I would like to tell you about is the Cooperative Arrangement we have with Florida.

The comptroller's office in the State of Florida processes copies of CTR's, which the banks file with the Federal Government, but there is State legislation which requires the banks to submit copies to the State comptroller's office and to report suspicious banking activity in amounts less than $10,000.

The banks are complying with this, and are filling out what amounts to a CTR.

Chairman ST GERMAIN. How long has that been in effect?

Mr. COWARD. Sir, I don't know. At least for a year or so that I am aware of. The banks are cooperating with this, and using the CTR form itself, marking it as suspicious activity and submitting this to the State comptroller's office, and they are entered into their computer system, and there is only a 7-day backlog, which is very good, and they are being analyzed.

If there are a series of suspicious reports being made by the bankers, these are being compared and the banks are being recontacted, the comptroller's office might call the bank——

Chairman St Germain. Give us an example of suspicious activity.

Mr. Coward. An individual that comes in on 2 or 3 days in 1 week with $9,500 to deposit in one account, or even separate accounts, anything of that nature. I don't believe the statute spells it out.

Chairman St Germain. You say you have seen some of those reports?

Mr. Coward. The reports come to us in the form that there has been suspicious activity. We get back with the investigators in the comptroller's office by phone and discuss the situation.

As they generally do some analysis first, we don't see all of the reports that they make. Because they are able to weed them out, only those they think have some meat to them are referred to the Florida Department of Law Enforcement and to our office. After some cursory computer checking here in DC, we farm them out to our local field offices, generally in Miami.

Chairman St Germain. A witness last week testified that he was going to the same 10 or 12 banks over a 1-year period once or twice a week, laundering cash in $9,000 denominations. Never once did anyone ever question him.

He also reported observing a couple of ladies while he was doing undercover work, doing the same thing in a couple of banks, and he was never the subject of a suspicious report. That is why I asked. He was operating between 1984 and 1985.

Mr. Coward. I would have to check to find out.

Chairman St Germain. Does H.R. 2785 contain such a provision, Mr. Trott? Would H.R. 2785 in any way require this type of suspicious reporting?

Mr. Trott. It wouldn't require it, but it would clearly permit it and encourage banks to do that by making it clear that any report of this type of activity would not go against the bank in some sort of a civil suit.

I might say that we have done a lot to encourage banks to become involved in this as part of the solution rather than part of the problem.

A tape has been made as part of a program for bankers by Mr. Saphos and Charlie Blair of the Department of Justice and others, describing money laundering techniques, and it is now being put on in 64 cities for 6,200 bankers.

Chairman St Germain. Tellers, managers or officers?

Mr. Trott. Mostly people in management.

Chairman St Germain. You know what the trouble is. The management people are not the ones who are going to catch the launderers.

Mr. Trott. I brought these tapes along, which I could furnish. Banks are making tapes to be shown to the tellers, putting up signs—this is from the Bank of Nova Scotia—putting up signs for tellers, other people, describing what the conduct is and encouraging them to report it to law enforcement.

The financial institutions want to be there and want to know——

Chairman St Germain. Has the ABA bought these tapes?

Mr. Trott. They paid for the series, I am advised.

Chairman St Germain. The ABA is encouraging this as well?

Mr. Trott. Yes, they sponsored the entire program.

Chairman St Germain. I am going to ask staff to check with the ABA to see what they are doing in this area, as well as the U.S. League, because I think the industry itself could do a great deal if they were to take advantage of this informational material that you have.

Mr. Trott. The industry must be at the frontlines as you point out, with the tellers. The tellers must know what this activity is, be able to spot it and be encouraged by the management of the bank to turn it in.

These tapes start out with the CEO of the Bank of Nova Scotia saying we do not want to help racketeers, and let's get in and solve this. It is a very good attitude, and I encourage all banks to continue that attitude.

Chairman St Germain. I interrupted Mr. Coward.

Mr. Wylie. I have a question on this point.

What is the usual source of your suspicious activity reports?

Mr. Coward. I am sorry, sir?

Mr. Wylie. What is the usual source of your suspicious activity reports?

Mr. Coward. They come through the State comptroller's office in the State of Florida. They are prepared by the tellers working the cages in the banks, and this may very well account for the fact that someone may or may not have been reported.

Suspicion is in the eye of the beholder.

Mr. Wylie. One State?

Mr. Coward. Yes, sir, it is a program the State of Florida developed on their own. In return for providing us with these reports, they have asked that we review the names they submit when they receive applications with regard to the change of control of a bank in Florida. They forward those names to us, and we review our indices and let them know if we have any activity with regard to those names.

They are very concerned about drug traffickers taking over banking institutions. We are providing the assistance they request and they help us with the suspicious activity reports. We are able to review the names for them which helps us, of course.

Mr. Wylie. Should we pass legislation which would require all State comptrollers to have some sort of a report?

Chairman St Germain. Mr. Coward.

Mr. Coward. I am through. I would like to echo Mr. Trott's comments that the banking industry itself is concerned and interested. DEA participated with the Department in the teleconference, and reached many of the bankers last year.

Since then, we have been asked by a number of regional banking associations to provide speakers. Our agents in the field have met with groups of bankers on several occasions, and the bankers have made it clear that they are very anxious to help us.

Generally, we are joined by IRS whenever we attend these meetings or make a presentation. IRS interprets the regulations and we encourage the banks to give us a call. We are finding that in those areas where bankers are more comfortable that they are not going to somehow be liable civilly or otherwise for revealing information to us they are quite willing to do it.

That is the reason that the clarification part of the pending legislation would be useful. It would put their minds at ease, and we would get more calls which would help our cause.

To conclude, as we become more and more proficient in our investigation of money laundering, and in particular with the seizure of assets from traffickers after the criminal investigations have been completed so that they are not able to go right back into business, or so their lieutenants don't go right back into business, we suspect the traffickers will become more sophisticated. We have got to stay alert to make sure our investigative techniques are up to date.

And we have to make sure that our laws stay up to date with them.

I think that the pending legislation will go a long way to accomplish that. We have a great deal to do, and I think the asset seizure route, and the removing of the proceeds of the crime, particularly in drug cases, is one of the best ways to attack the problem.

[The prepared statement of Mr. Coward on behalf of the Drug Enforcement Administration [DEA] can be found in the appendix.]

Chairman **St Germain**. Thank you, Mr. Coward. Your testimony has been beneficial and helpful.

We, however, have limited jurisdiction. In other words, there are certain portions of H.R. 2785 that come within the jurisdiction of this subcommittee and full committee; but other provisions do not. It is our hope that we can at least move those portions that come within our jurisdiction.

The Comprehensive Crime Control Act of 1984 raised the criminal penalties for not reporting violations by imposing a fine of $250,000 or imprisonment for not more than 5 years or both. H.R. 2785 would substantially raise those criminal penalties.

Some are impressed by these provisions, others are troubled by them. What bothers me, with the cases you cite; this *Orozco*, for instance, found guilty of conspiracy, and then sentenced to 8 years in prison.

I checked with one of my counsels and he says that you are usually eligible for parole on most Federal crimes after a third of the sentence has been served, with time off for good behavior. So, probably an 8-year deal would amount to 4 months.

Perhaps this man will serve 2½ or 2 years, if he is a good boy?

Mr. **Trott**. Yes, early release on the parole system is distinctly probable for everybody now in the system.

Chairman **St Germain**. He was fined $1 million. He laundered $150 million over a period of time, that you are aware of. Who knows, really and truly, how much he laundered?

A lot of people have to work a lifetime to make the kind of money that this fellow probably has got stashed away. So he did this for years, and he will spend only 2½ years in a Federal penitentiary where the taxpayers of the United States are going to feed him, clothe him, bathe him, and entertain him. After 2½ years, he comes out, goes anyplace in the world and retires for the rest of his life.

Last week, we received testimony as well, and we were told by one money launderer who laundered millions and millions of dollars, and he probably, according to the percentages the smurfer was getting, made himself a couple million dollars, and was only given a 3-year sentence.

They seized hardly any of his money. He probably put away $2.5 to $3 million, not a bad deal. It is all well and good to talk about increasing these penalties, but if Justice is going to negotiate in the way they have been to date, for sentences to be reduced to such a minimum amount, you wonder whether crime does pay after all.

Mr. TROTT. I think that the No, 1 fix to the problem you point out is in the law passed by Congress in 1984, abolishing the system of parole. We now have a sentencing commission that is meeting regularly to design new guidelines for sentencing.

We used to call it the truth in sentencing bill, and we are very delighted that that is now the law.

When it kicks in, it will say when a judge sentences somebody to a certain sentence, that that sentence is going to stick, and there won't be a parole commission that cuts it down by two-thirds.

Mr. Saphos advises me this is a gentlemen who handled $240-some million and got a 6-year sentence out of the process. What you are driving at we agree with completely. Not only must there be substantial prison penalties, but complete forfeiture and massive fines to provide an adequate penalty for this activity, and a deterrent for others who might be thinking about engaging in it.

Chairman ST GERMAIN. According to the Privacy and Protection Study Commission Report, Justice William Douglas, in this instance, observed, "The banking transactions of an individual give a fairly accurate account of his religion, ideology, opinions, and interests."

Moreover, the emergence of a checking account as an economic and social diary for many individuals, is one reason why commercial banks are acutely aware of keeping their clients' financial affairs confidential.

Yet, as is noted in chapter 1, the Supreme Court recently rejected the notion that such expectations of confidentiality are either warranted or legally enforceable.

This is one of the items that gave rise to the Right to Financial Privacy Act.

Now, in H.R. 2785, you ask that we immunize the banks in order to encourage them to report; that is, give them immunity from civil suit. I asked the question last week, and I ask you, Mr. Trott; do you disagree?

John Q. Citizen sees a crime being committed or reports what he thinks is a crime being committed. If indeed they have done this, not because a crime was committed, but because they had ill-advised intentions, or feelings for the individual that they report against, they then are liable to a civil suit for damages; are they not?

Mr. TROTT. That is——

Chairman ST GERMAIN. Anybody is liable for a civil suit if you falsely accuse someone?

Mr. TROTT. That usually will result in a civil suit, if the person so accused desires to bring one.

Chairman **St Germain**. Are we going to immunize everybody from civil suit? My point is, why do we have to give banks special treatment to encourage them to be good citizens?

Mr. **Trott**. It is not that we are giving them special treatment. It is that banks, and they are able better to describe this, they are between the proverbial rock and a hard place.

They are encouraged to become the frontline enforcers of this country's drive to stop money launderers. Yet, in some situations, they find themselves in States where financial privacy laws seem to indicate to them if they start reporting this stuff, they might get sued, so as a good counsel for a bank, before I would counsel them to go ahead and report something, I would make sure they are not sticking their foot in a civil wringer.

When a bank has reason to believe there is funny activity going on, if the bank reports that activity to law enforcement, the bank won't have to worry about being sued, not that any bank can slander anybody.

Chairman **St Germain**. I wouldn't imagine that would be the case. Banks certainly have been, and will always be, cautious about that.

Mr. **Trott**. Very careful.

Chairman **St Germain**. Do you agree with the quote that I read from Justice Douglas? You show me an individual's checking account records and/or credit card records, and you know all about that individual.

How about the Senator a couple of years ago that used a credit card for some funny activities? He is no longer a Senator. Those cancelled checks, records, they can be pretty devastating, and that is why we have to be, and are, and have been, very cautious about toying with this.

We will get back to this on my next round of questioning.

Mr. Annunzio.

Mr. **Annunzio**. I would like for Mr. Trott or Mr. Coward to explain just a simple transaction to me. We talk about all this money laundering. For instance, a man sends $5,000 to a European bank, and then they have a dummy corporation set up. This man draws his salary from the dummy corporation, and the check comes back to this country again. He gets this check, and he opens up a legitimate bank account. He pays his taxes on this money. He invests the money in tax-free bonds where he pays no taxes. He buys real estate where he gets depreciation, and pays very little taxes.

Take me through how they established this company in Europe, or is it already established? I am trying to put for the record a simple explanation so my constituents know what we talk about when we talk about money laundering.

Mr. **Coward**. There are a variety of ways in which they can set up the overseas corporation.

Mr. **Annunzio**. I come to all these hearings and I have seen it, and I know the banks that have been fined and the ones that have not been sent to jail. I want you to take me through one of these steps so I can understand it.

Mr. **Trott**. A simple description of how a money laundering scheme might work?

Mr. **Annunzio.** I want that for the record. We are not experts. Our chairman is an expert.

Mr. **Trott.** I will let Mr. Saphos do this, because he has been in the field for years coping with these things.

Mr. **Saphos.** Two different examples with the same amount of money. Say we have a domestic narcotics trafficker, a fellow who lives in Alexandria, VA. He made $50,000 last week selling dope to our children out in front of a school. He wants to live on Ridge Road, live very well, and invest in leasing his Rolls Royce with that money.

But he has the $50,000 and he can't walk down to his local bank and deposit it in this account with all these $20, $5 bills that are so tainted with his contact with the narcotics, the Customs narcotics detector dogs will alert to the odor of narcotics on the money.

He can't deposit it in his bank, because the bank will report him. He has to figure out some way to conceal its origin, identify it, and get it back so he can use it.

The traditional way that has been used by the bad guys is he takes that money, hires somebody, goes down and bribes the lowest paid person at the bank, the teller, all those Phi Beta Kappas that are hired for $11,000 a year that have a lot of time to think of ways of avoiding the reporting requirements, bribes this person to take that money and deposit it into 11 different banks accounts that are made out in fictitious names, so it looks like 11 people had 11 different transactions, each of $4,000, it looks like.

He converts it into hundred dollar bills and he flies out of the United States with it strapped to his waist. In both those instances, where he caused that bank not to file that report, that should be illegal; and when he convinced that employee not to file that report, that should be illegal.

In the other instance where he straps it to his body, flies out of the United States, he was required to file a currency and monetary instrument report with the U.S. Customs Service, and his failure to do that under the Bank Secrecy Act should be illegal, but our search authority is extremely limited.

When he gets out of the United States, he can purchase in most bank haven countries an off-the-rack corporation. For $2,500, he can buy a corporation, with a corporate president, corporate stock, and therefore his name as the owner of that corporation is never registered anyplace.

With that corporation, he then opens up a foreign bank account, and will do it in two different banks, in two different jurisdictions.

He will put the money in one, and the second one will lend money to his own domestic corporation on paper. He is wire transferring the proceeds of the alleged loan back to himself in the United States.

His U.S. corporation that puts him on a salary, pays him a contract as a retainer and he collects the salary, and he even gives himself a tax deduction for payment on the interest on the loan that he never made.

Mr. **McKinney.** He also loans to himself, because there is no tax that has to be paid. And if you borrow it from yourself from a legitimate bank with a U.S. border in between where you borrow it, and from here, you get a free ride on the money?

Mr. **Saphos.** Sir, if he wants to hurt the IRS, he gives himself a deduction for the interest he doesn't pay.

Mr. **Annunzio.** In other words, even after he legitimizes the money, he gets it in clean money, he still tries to figure out ways of not paying taxes, even on money that he launders and cleans up?

Mr. **Saphos.** Sir, exactly right, and the second scenario, this $3.8 million, part of that $242 million, that man had deposited in one bank account in one bank in the United States.

That money was going offshore and going into the pockets directly of the narcotics dealers offshore; and the way that transaction took place was, people in the United States bought cocaine on consignment.

Within 21 days, they had to pay the trafficker who imported that cocaine in the United States for all that cocaine. He, the trafficker in Colombia, has no need for $20 bills that weigh more, take up more volume than the cocaine he smuggled into the United States, and he has very limited ways of smuggling it back out, so he hired a man and that man will take all that dirty money, slip it into the U.S. bank and sell that money to a legitimate Colombian businessman who then gives the money launderer pesos for the U.S. dollars, and the money launderer gives the narcotics trafficker pesos.

He needs the pesos, that is how he runs his business, on pesos. And the businessman who gave the money launderer the pesos then comes to the United States, and they pick up his dollars, and with those dollars they purchase tractors from the Ford Motor Co., products from Danville, VA, so when we ran around Miami, we were finding the money going to the Ford Motor Co.

The transaction occurred in Colombia, and other bank secrecy locations where we can't pierce it.

Mr. **McKinney.** Could we just, for the record, state that a Lear jet is a $1.2 million investment but that is peanuts, if you are carrying $6 million, or $20 million worth of cash or cocaine, and really have not earned the money anyway? If you lose one, you lose one.

Tough luck, you will start again. The record needs to show that what you and I think is expensive, is peanuts to the drug dealer.

Chairman **St Germain.** Let's keep regular order here.

Mr. **Annunzio.** My time has expired a long time ago.

Chairman **St Germain.** Mr. Wylie.

Mr. **Wylie.** Maybe you can remember where you were there in a few minutes. I was getting into the so-called suspicious transaction activities, reports that you talked about here a little while ago, Mr. Coward.

Most of the money laundering is related to drug trafficking, is that a fair statement?

Mr. **Coward.** It involves other crimes, but principally drug trafficking.

Mr. **Wylie.** Mr. Saphos, you mentioned a couple of scenarios. There was laundering of money, how it comes about, and in each case, you mentioned bank several times. Is most of the money laundering that we know about involved with a bank, or are thrifts and credit unions involved?

Mr. **Saphos.** Perhaps the salient term in that is that we know about, because of the Bank Secrecy Act, the reporting requirements allow us to get a foot in the door, to learn about that limited aspect of the money laundering gain.

In the same vein, it has encouraged the money launderers to use other means other than financial institutions to perform their activities. Just being sent to the Federal Reserve Branch in Miami, FL, in excess currency is $120 million from the Republic of Panama, most of it in $100 bills.

That would indicate there is a substantial amount of U.S. currency illegally being transferred offshore to avoid the U.S. financial institutions.

Mr. WYLIE. How did we get to that?

Mr. SAPHOS. Sir, one of the ways, as my boss will tell you——

Mr. TROTT. One of the major impediments in this war against narcotics trafficking has been the bank secrecy jurisdiction, where when we follow the financial trail, we run into a curtain that we cannot pierce.

What we have done is make it one of our highest priorities, is to sit down with the governments of these countries, and negotiate with them either an executive agreement, such as the Cayman Islands, or mutual agreement, legal assistance treaties, that will enable us to get financial information from institutions from these countries.

It involves the change of their own domestic law that will allow this to occur.

We are sitting down discussing this right now all through the Caribbean. We are trying to target these jurisdictions. I have met with the ex-attorney general of Panama. It requires us to sit down with these countries, changing law, sharing information on an international basis.

Mr. WYLIE. If the end part of the transaction is taking place in the United States, there has to be some entity involved in the United States in the transfer of money?

Mr. TROTT. This currency is coming back to the Federal Reserve as excess currency.

Mr. WYLIE. To where, just to the Federal Reserve?

Mr. SAPHOS. Yes, sir; used as a corresponding balance for an offshore bank. Sir, there has to be some entity in the United States which is doing activity just like that activity of a bank, and they are accepting currency, doing things with it, and that is wrong.

If we are to proceed against them with only the current legislative authority we have, I have to prove that that person who is sitting in a double-wide trailer in Hialeah, FL, getting duffel bags of money every night into his home, I must prove he knows he is a financial institution, and he has to file a CTR, and he willfully and knowingly did not file a CTR.

That burden is unprovable without doing a brain scan on the defendant. Our new law, which does not require him to be a financial institution to be a money launderer, allows me to prosecute that person.

Mr. WYLIE. Apparently, there is a considerable amount of money laundering going through legitimate banks, banks organized for sometime and are old, well-recognized in the community, and highly regarded and thought of, not just the guy in the trailer who is in effect a financial institution.

Employees of banks, some banks at least, need to be more alert. The chairman described the situation of Mr. Freidberg the other day, where he went into one bank six times in 1 day with $9,000 each time, and nobody was alerted to the fact that that was a suspicious activity.

Now, maybe it is too much to expect the teller to be alerted to that sort of activity. At the end of the day, isn't there some sort of an accounting procedure, so that if they saw this particular person or somebody putting in $9,000 six times in a day, that would be a suspicious activity?

Mr. TROTT. Yes, and I don't think it is too much to ask of a teller. I pointed out, what the Bank of Nova Scotia has done, it is one of the largest banking entities operating in the Caribbean.

We have met with all the Canadian banks that have outfits down there. They are training their tellers to be watchdogs on this. They have these posters, and their own magazine called "The Scotia Banker," that says "Dirty Money Just Doesn't Wash at Scotia Bank," and these training tapes, "Laundromat Blues," and the other is called "Don't Get Caught in the Wringer." They show a person come up, and they go through the transaction, and they stop and say, "that person is a money launderer," and they analyze why, and give the information tellers need to spot what is going on, and tell the tellers exactly what they ought to do under these circumstances, and encourage people to come forward.

Mr. WYLIE. That is the point I wanted to make, plus the fact I think the point has been made several times, and in some cases, maybe a teller is paid off, but even if that teller or individual in the bank is paid off, wouldn't that activity show up on a sheet of paper at the end of the day?

Mr. TROTT. Yes, it does.

Mr. WYLIE. So that somebody else would have to have at least two people involved in the transaction. Otherwise, it should be reported as a suspicious activity?

Mr. TROTT. Yes, for a long time, especially our major banks were oblivious to the Bank Secrecy Act reporting requirements, and that is why you are seeing large financial institutions, Bank of Boston and others, being charged with various offenses, both civil and criminal, and now internally, they are changing their rules, regulations and procedures, not only to comply with the currency reporting requirements and everything else, but to spot money laundering activity and do something about it.

Mr. WYLIE. I am going to stick around for a few more questions.

Chairman ST GERMAIN. Mr. Trott, regarding the Bank of Nova Scotia, why didn't you give us something like this from one of our American banks?

Mr. TROTT. The Sun Bank is one, and as I indicated before, Mr. Saphos pointed out we have had 6,200 bankers in 64 cities.

Chairman ST GERMAIN. That is not my question. You bring in an example, the Bank of Nova Scotia, a Canadian bank. My father was born there. I have nothing against Nova Scotia. Why didn't you bring something like this in that has been done by an American bank?

Mr. TROTT. The American banks are making these tapes. I don't have any of them.

Chairman St Germain. How about your colleague?

Mr. Saphos. I regret that we did not bring in any of the training tapes that have been developed by American banks, and several have. The reasons we are reluctant to bring them in is, they are a product being sold from one bank to another.

We have to buy them probably, and because of many things, I don't have the budget to purchase them.

Chairman St Germain. Would you be good enough to provide us the names of the banks, and then——

Mr. Saphos. Bank of America.

Chairman St Germain. Sun Bank?

Mr. Saphos. Sun Bank has a program of teller education in which they have live speakers, and we provide, when requested, many of those live speakers to go down to the teller level in the evening when the banks are closed, and speak to the tellers, to identify to them the money laundering efforts.

Chairman St Germain. Which other bank?

Mr. Saphos. Has the training perhaps?

Chairman St Germain. Gentlemen, how about when something is—I thought perhaps the reason you brought this in was because you thought it was one of the superior products?

Mr. Saphos. I do think it is a good product, sir, a good idea.

Chairman St Germain. You said Bank of America. Are there any others?

Mr. Saphos. Barnett Banks of Florida have a program. There are others.

Chairman St Germain. Not program. Something we could look at.

Mr. Saphos. The American Banking Association has a full-day educational tape program.

Chairman St Germain. I will ask our staff to contact these people, so we can get some examples. It is important that we demonstrate American banks are doing this as well.

Mr. Trott. The particular reason I used this bank is because this involved bank secrecy problems in the Caribbean we were bumping up against, and I cite these banks as banks that have turned around and are now helping us.

Chairman St Germain. Ms. Kaptur.

Ms. Kaptur. Thank you.

Chairman St Germain. Wait, I am sorry, Mr. Torres was here first.

Mr. Torres. Thank you, Mr. Chairman. I have no questions at this time.

Chairman St Germain. Ms. Kaptur.

Ms. Kaptur. Thank you, Mr. Chairman.

I wanted to ask a few questions here, first of all, under existing law, do you see an increase in detection of this type of activity?

Mr. Trott. You couldn't even put it on a chart. Five years ago, there wasn't much being done in this area at all, and now we have the IRS, Customs, DEA, FBI, U.S. attorney, Organized Crime Drug Enforcement Task Force Program, and we are identifying drug traffickers and money launderers, yes.

Ms. KAPTUR. If you charted the amount of money forfeited to the Government to date, would it be increasing, and for last year, what might that figure have been?

I may ask another question, as Mr. Annunzio asked, I don't claim to be an expert in this area, but I am interested, if you were to attempt to categorize the variations in activities in laundering activities, you have cited different examples, but is there any way in which you sort of divide the universe to the unprofessional eye looking at this, to make it easier for us to understand?

You talk about domestic versus international, and people going into banks or people buying businesses. You talk about hiring attorneys. Is there any way of putting those in categories, the range of activities?

How would you define it by category?

Mr. TROTT. It is difficult to do that because every operation seems to be a little bit different, and these people are clever enough so they are constantly looking for new and changing ways to take dirty money and disguise it as clean money.

They have all kinds of schemes. In Puerto Rico, we had a problem with buying lottery tickets at a premium, and so anything you come up with that is a category is dangerous, because that is what we have managed to do in the past.

You have to stand back generically and describe what they are up to.

Ms. KAPTUR. If you looked at the detection on the domestic side and on the international side, which event or activity tripped the system and made you aware, say, on the domestic side?

We had some witnesses in here last week, and they said the CTR reports were the most effective means of detection. What would you say on the domestic side, which two or three events, whether it was a CTR report or whatever?

On the international side, the same question. What tripped the system? What helped you to detect more examples of wrongdoing in both situations?

Mr. TROTT. The CTR's have been very, very important, and those have given us a handle on the flow of cash. There is a particular agency called TFLEC at Customs Service that looks for patterns and blips.

TFLEC, Treasury Financial Law Enforcement Center, located here at headquarters, that analyzes these reports using regression analysis and other ways of attacking this to target suspicious transactions and turn them over to investigators.

The cash transaction report has been important, as have various initiatives such as Operation Greenback and standard drug investigations, conducted by DEA, FBI and others.

Ms. KAPTUR. All right, and what about the figures I have requested? Have you located those?

Mr. TROTT. It is going to take us some time to plow through here.

Ms. KAPTUR. How much would you estimate for 1985, might the Government have been forfeited? $50 million, $25, $100?

Mr. TROTT. Assets forfeited through December 31, 1985, by the Organized Crime-Drug Enforcement Task Force Program alone is $56 million-plus.

Ms. KAPTUR. That would have been for that fiscal year?

Mr. TROTT. Yes.

Ms. KAPTUR. Thank you.

Mr. TROTT. For 1983, 1984, and 1985, is $108 million plus, total.

Ms. KAPTUR. On the international transactions, and your ability to detect illegal activity there, again is it the CTR report or drug investigations?

Mr. TROTT. Primarily drug investigations plus the financial information that we have tried to get from foreign financial institutions, and that is why the Mutual Legal Assistance Program, and the Executive Agreement Program, and bilateral agreements between countries is so important.

We must be able to get the information. Crime has to always be viewed as a global problem now, just like the economy. Anybody who sees crime as just a State, or local, or national situation is missing the true dimensions of this, and once you see crime as an international problem, you have to have international solutions to attack it.

We have to reach out with treaties to other countries to provide us international information.

Ms. KAPTUR. Thank you, gentlemen.

Chairman ST GERMAIN. Mr. Barnard.

Mr. BARNARD. I don't think I am next, Mr. Chairman. Am I next?

Chairman ST GERMAIN. You are.

Mr. BARNARD. Thank you, Mr. Chairman.

Mr. Trott and Mr. Coward, how closely do you all work with the IRS?

Mr. TROTT. I think we work very closely. The Organized Crime-Drug Enforcement Task Force Program brings together the resources, energies, and capabilities of all the Federal law enforcement agencies with a handle on this, so you have single task forces working together, IRS, ATF; for example, all the agencies that can impact on drug trafficking.

Mr. BARNARD. No turf battles going on there?

Mr. TROTT. There are—it is not accurate for me to say there are no turf battles, but none with the IRS. They are a full partner in this and provide law enforcement with the special expertise you need in financial investigations.

The Organized Crime-Drug Enforcement Task Force Program, we have jurisdiction investigation task forces around the country.

Mr. BARNARD. We have already seen in bank crimes, what we have been able to very well pinpoint a criminal conduct within banks, Justice Department has been very, very slow to work on referrals by banking agencies, the Comptroller of the Currency, I hope that does not exist between Justice and IRS, because the conviction rate for the Justice Department hasn't been all that good in bank crime, and I hope you all are doing better as far as this money laundering, and I guess you would like to see it strengthened with H.R. 2785.

But too many are getting off too lightly, and if this bill is going to help you in that problem, we need to press forward to get that done, but it concerns me sometimes. What is your opinion?

Do you think that the rate of convictions is good, bad, or what?

Mr. **Trott**. I think it is very good. In the last 5 years, Federal law enforcement has stepped up the pace tremendously, and we are now doing things not even contemplated before.

Mr. **Barnard**. Still, the sentencing, the penalties are not that severe.

Mr. **Trott**. The sentences have been far too light for the activity.

Mr. **Barnard**. Why?

Mr. **Trott**. A lot of reasons. Frankly, some judges, and I hate to start talking about judges, but some have not seen this as much of a serious problem as we see it; and when they are confronted with espionage cases, bombers, all the rest. On the general scale of things, money laundering has been regarded as one of the lesser problems, and also a sense that the Federal prisons are getting full, so the sentences are tailored to that problem.

But we hope, through the new sentencing commission, is to spell out for judges the seriousness of this type of conduct, so across the board, across the country, money launderers who enable narcotics trafficking activity and other racketeers to succeed are plastered so severely by their sentences that there will be a major disincentive to get into this type of business.

Mr. **Barnard**. Last week, Assistant Commissioner, Criminal Investigation, IRS, Mr. Richard Wassenaas, testified before this committee that during 1985, the IRS recommended prosecution of 137 cases involving money laundering.

Can you tell me how many of these recommendations were pursued by the Department of Justice?

Mr. **Trott**. I can't. I will try our best to furnish that for the record.

[The information referred to can be found in the appendix.]

Mr. **Barnard**. Since these cases have been found against some of the prominent banks, all of a sudden we find a proliferation of forms being filed as of cash transactions, and it was brought out we had 517,000 or so, anyway, it has gone out of the roof.

How do you expect to follow up on that many reports?

Mr. **Trott**. With the use of computers and TFLEC.

Mr. **Barnard**. How are computers going to do it?

Mr. **Trott**. When you input this information into computers, and you are able to massage it as a group.

Mr. **Barnard**. What have you been able to do?

Mr. **Trott**. Identify many, many situations in various regions that appear to be ripe for money-laundering investigations, that have been converted into money-laundering investigations, that have resulted in Federal prosecutions and incarceration.

Mr. **Barnard**. Are you noticing any increase because of these tremendous new filings, are you noticing enough increased activity to pursue some prosecutions, or some investigations?

Mr. **Trott**. Yes, this technique is producing many investigations.

Mr. **Barnard**. Do you have some record as to what that success has been over the last 6, 12 months?

Mr. **Trott**. We can try to provide you with a better picture for the record.

Mr. **Barnard**. It would help the committee in determining whether or not if we need to take some further strengthening steps, as far as the Bank Secrecy Act is concerned, Mr. Chairman.

All of a sudden, it will put a tremendous burden on Justice and IRS to followup on these filings, and that comes along with the Gramm-Rudman bill where you are going to be reducing agents, so forth.

We are getting deeper in the problem rather than the solution.

Mr. **Trott**. TFLEC is located at Customs Service in Washington, a group of 30 intelligence analysts who examine this information, enter it in a data base to determine the need for criminal investigation.

One result, one report generated showed that geographically, the financial institutions in Puerto Rico were filing fewer CTR's than their cash-flow should generate.

As a consequence, the Departments of Justice and Treasury initiated something called Operation Greenback Puerto Rico. This operation is continuing. To date, investigations initiated by that task force have resulted in a conviction of 17 individuals, 1 savings bank and a corporation for money laundering activities.

Greenback Puerto Rico has resulted in the seizure of 5.7 million in monetary instruments, and the imposition of $500,000 in fines.

An agent in South Florida receiving information that a Miami CPA might be participating in money laundering activities is another example. Reports confirmed the agent's information, produced a multiagency investigation, resulting in a 35-year prison sentence, and a fine as well as the seizure of 5.4 million in cash, two automobiles, a Leer jet, 65 pounds of cocaine.

We are set up with computers, analysts to take this information and convert it into successful law enforcement activities.

Mr. **Barnard**. What about the Northeast?

Mr. **Trott**. As soon as the Bank of Boston got the publicity that it did with its prosecution by Bill Weld, all other financial institutions began to check their own procedures to see if they were following Federal law.

Mr. **Barnard**. Maine and Florida, we don't stick out like that.

Mr. **Trott**. The activity has caused all banking institutions to go back and check. The filing of these reports is astronomical as compared to 3 years ago.

Mr. **Barnard**. Race tracks, dog tracks, do you check the money that comes in through those sources?

Mr. **Saphos**. The Treasury made those types of places non-exemptable by the banks, so when the race and dog track go down and turn their money in to the institution, they can't be on an exempt list the way your local grocery store is, so we can measure——

Mr. **Barnard**. How many dog tracks and horseracing tracks are owned by the traffickers?

Mr. **Saphos**. If I knew that, sir, I would probably be in court rather than here. The State of Florida, where you are from, sir, does have one of those laws that require the CTR's being filed to the State, so they can also take a look at those race tracks.

Mr. **Barnard**. Don't look over your shoulder, I hope they are not finding more ways to launder money than we are finding to close it.

Mr. **Saphos**. Cases generated by this increase in CTR's under our Organized Crime-Drug Enforcement Task Force Program, who we have by our guidelines instructed, they must look into the money laundering aspect of each investigation. The number of indictments charging money laundering have increased from 49 in 1983 to 110 in 1984, to 141 last year.

Likewise, the number of defendants charged with money laundering, this is just out of the OCDETF cases, 19 in 1983 to 78 defendants in 1984, to 130 defendants last year. That is one of the programs we have to examine money laundering activity and prosecute these violations.

Chairman **St Germain**. Mr. McKinney.

Mr. **McKinney**. Thank you, Mr. Chairman. I would like to state that we are being overwhelmed by the gentleman from Georgia, and I congratulate you gentlemen on trying to at least tackle 10 percent of the problem, which seems to be the legit banks.

It was a bad night for me last night to rent Scarface, with Al Pacino, and watch the drug laundering business in Miami, because I knew it was there and even Hollywood couldn't put too much of a lie to it.

What percentage of this money would you guess is going through banks?

Mr. **Coward**. I really don't know. There is no way to measure the unknown.

Mr. **McKinney**. Very small percentage now, wire transfers, real estate purchases, off-State banking, et cetera?

Mr. **Trott**. There is no doubt they are trying to keep money away from the Bank Secrecy Act. If you and I were money launderers, the last place we would be taking our cash to right now would be a bank in the United States.

Mr. **Coward**. Some of it is going over the Canadian border. The Canadians are very concerned about that problem. The airplanes are still flying to Panama on a regular basis, and disgorging large amounts of cash.

Mr. **McKinney**. Going to visit the colonel, and not the Kentucky Fried Chicken one. Should we put a cease and desist order on Americans' ability to deposit money in these foreign banks?

Should we bring more diplomatic pressures, pass a law, do something? No one can go to the Bahamas or any of those places and look at one law office with 57 corporations stuck around the brass plaques and not know what is going on in a hurry.

Is there something we can do?

Mr. **Saphos**. One of the things I would suggest you could do is the right of a financial institution to do business is not a right, but it is something which is bestowed upon people by the laws, by the Congress of the United States.

They are given the ability, you bestow upon persons the ability to earn a living by being a financial institution in this country.

I would suggest that it is a privilege, then, of being a financial institution in this country, who also operate in bank secrecy jurisdictions should be conditional upon those institutions agreeing to abide by a process of the U.S. Courts to disclose those books and records, no matter where they exist.

An institution has to make a choice. Does it make good business sense to do business in the United States, and if so, is that good business of such magnitude that they will give up the bank secrecy they enjoyed in foreign jurisdictions, and the business sense it takes to endorse accepting that dirty money offshore?

Mr. McKinney. These are just hypothetical questions. My tendency is to think here we are, struggling with the banks, and they are becoming less and less of the problem and more and more of the problem is becoming all the wire transfers, fake corporations, and loans.

Part of this issue falls under the jurisdiction of this committee, and as the chairman said, we want to handle at least that part of it. This is a nasty question, but it has to come forth sooner or later.

For example, take the young bank executive in Miami who is making $40,000 a year and someone offers him 3, 5, or 10 percent of the laundry process. That is a pretty tempting offer when you are dealing with millions and millions of dollars.

Is that still going on?

Mr. Saphos. I would be foolish to say that it is not going on at all, but the incidence of those types of cases have been reduced over the years, because the top management of that institution that is paying that $40,000 has figured out that the amount of money that the institution can make from having those deposits, as opposed to the amount of money the institution will lose, even if it is not guilty as an institution of a criminal violation, don't balance out, so they are giving more scrutiny to the conduct of that young officer than ever before, and perhaps they are cutting down on the incidence of that behavior.

The number of prosecutions that we are initiating against the persons in that position in the legitimate financial institutions appear to be going down.

Mr. McKinney. While the bank is advertising with a full-page ad, one of their executives is caught. Publicity is one of their worse enemies.

Mr. Saphos. Yes, sir, we sent out an agent who closed down 11 financial institutions in San Juan, PR, so they could execute search warrants that day. It didn't bode well for the retired folks keeping their money there, and they decide to move it someplace else.

Mr. McKinney. I know a few of my constituents were upset by the names of people they saw on the TV that night, and I congratulate you for that raid. It was planned with all the precision of a military operation.

Mr. Saphos. We had an awful lot of professionals helping us, yes, sir.

Mr. McKinney. What about foreign banks? Is there something we should be looking at with these?

Mr. Saphos. Perhaps the same thing. When you give that foreign bank the privilege under the Edge Act, the privilege of doing business in the United States, perhaps you could make it a reciprocal agreement.

It must agree to make its records available to examination.

Mr. Trott. The domestic law of the countries where they work would do just the opposite, so it would create an ally in the banks. The banks then might turn to the foreign jurisdictions and suggest that these secrecy laws ought to be changed so they can participate in the worldwide economy, rather than in just one particular country.

If you do business in the United States, you have to cough up records in other places. Canada and Great Britain came into the picture and negotiated an executive agreement. If the Attorney General needs bank records and gets a certification and transfers that certification to the appropriate counterpart, the authorities in the Cayman Islands, now we have records in over 100 major narcotics trafficking cases which have been helpful.

Mr. **Wortley**. Don't you think your treaties would be more effective if you limited them strictly to narcotics situations? We found in Panama, Switzerland, that they are not too interested in cooperating when they think you are also seeking tax evaders.

Mr. **Trott**. We understand.

Mr. **Wortley**. We may see the hard evidence that you are on the trail of a narcotics trafficker who was laundering money, that is one thing; but when they think you are going to look for tax evaders, then their dander gets up.

Mr. **Trott**. You are right. As much as we would like to include in our treaty the ability to get information to go after tax evaders, tax avoiders, we don't because of the country's refusal to give us that information.

We began to tailor these agreements. Organized crime, theft, both countries recognize as a crime, then we have more success.

Mr. **Wortley**. How many countries do we have a mutual assistance treaty with?

Mr. **Trott**. Right now, we have entered into treaties with Switzerland, The Netherlands, Turkey, and Italy.

We have signed and secured Senate advice and consent to treaties with two more countries, Morocco and Colombia, which have not yet ratified the agreements. We have signed but not yet ratified an MLAT with Canada, and just last month, Attorney General Meese signed an MLAT with Thailand.

We are currently negotiating treaties with several other countries, including the Bahamas, Jamaica, the Cayman Islands represented by the United Kingdom, Germany, Israel, and Sweden.

We are exploring negotiations with Panama, Australia, and Austria, and hope to initiate talks with the United Kingdom itself later this year.

I just came from Mexico, where Attorney General Ed Meese began negotiations with the Attorney General from Mexico on an MLAT with Mexico.

In the area of international narcotics work, these MLAT's are our highest priorities.

Mr. **Wortley**. Making any attempt to get ahead of the game? We were told in Austria and Zurich that they anticipate the next marjor money laundering center is going to be in Budapest, Hungary, because of the free flow of traffic from Austria to Hungary, plus the fact that Budapest was becoming a financial center of the Eastern bloc nations.

Have you worked on that one yet?

Mr. **Trott**. In the U.N. conventions, which is an update of something that has not been touched in years, we are adding money laundering as something that will be regarded by all signatories, all members of the United Nations; that is new.

Have we addressed Hungary specifically? No. I am glad you bring that up. You are right, in one sense, as soon as we jam them in one jurisdiction, they are off to someplace else, and that is a function of satellite communications, international banking networks. As soon as we are there, they are gone, but our objective is to anticipate where they might go, and to follow them everywhere with this activity, which is extraordinarily difficult to negotiate.

But now, more and more countries are recognizing that they are in this together. No single country standing alone has the capacity to combat this. We have to all stand together. Governments are recognizing this in terrorism, drug trafficking, all the rest.

That is the encouraging news and now it is up to us to get together with those governments and hammer out these treaties.

Mr. WORTLEY. Keep working hard at it.

Chairman ST GERMAIN. Mr. Trott, we hear all this wonderful stuff about the Bank of Nova Scotia. We find out that there was a case with the Bank of Nova Scotia against the United States, a subpoena upheld and enforced on a bank——

Mr. TROTT. Right.

Chairman ST GERMAIN [continuing]. Notice how they get religion, once the courts said you better well do it.

Mr. TROTT. I understand exactly what you are saying.

Chairman ST GERMAIN. All of a sudden, once a couple of large banks had fines imposed upon them, they were born again dogooders; right?

Mr. TROTT. I am not here as an advocate for or against any bank, but they were in a situation where the law in the Cayman Islands would have subjected them to serious problems. They kept saying we are between a rock and a hard place.

Chairman ST GERMAIN. Didn't they bring the case?

Mr. TROTT. No, that was a case that we brought to enforce subpoenas.

Chairman ST GERMAIN. I am going to have to have my staff get their glasses out. It says the Bank of Nova Scotia against the United States. From this, it seems to me, that it is the bank that brought the action; correct?

Mr. TROTT. We filed—we subpoenaed the records from the bank. When the banks refused to comply, then we took the case into court for subpoena enforcement, and so it was really at our initiative.

The banks did file certain motions and actions to reduce the amount of the fine, but we were the initiators on that, and I have sat down with bankers everywhere—well, if you want to know the whole story, it got so hot at one point the Canadian Government intervened and had the Prime Minister write a letter to the President of the United States suggesting that we were interfering with Canadian sovereignty.

The Minister of Justice came down and had a long and protracted meeting with the Attorney General of the United States William French Smith and we hashed this out and got down to brass tacks. Who are the bad guys and who are not? Then we generated the activity which resulted in the agreement now proceeding toward a Mutual Legal Assistance Treaty.

Mr. McKinney. My time has expired. The mood of Congress was to protect the little guy, and let them go after the big guy.

The big guy has enough lawyers in-house to protect himself from any problems. I think the Bank Secrecy Act is being misused by many people. I appreciate what you are doing with limited staff, bad laws, and little cooperation, because there is no question about it, the drug business exists because of the money it produces, and we are at war with the dealers as much as we are with Colonel Qadhafi.

At least you can sit and talk to him. I doubt if you can talk to these animals.

Chairman St Germain. Mr. Wortley.

Mr. Wortley. Mr. Coward, in your testimony, the second page here, you talk about the Drug Enforcement Administration acts as a liaison with Interpol, the United Nations, and you talk about your cooperation with the Federal Bureau of Investigation, Customs Service.

If we are really concerned about money laundering, why don't we work more closely with the central banks, foreign central banks? That is where the money is flowing through.

Do you cooperate with them?

Mr. Coward. We cooperate with the law enforcement agencies in places where the central banks are permitted to cooperate with them such as Switzerland and as Mr. Trott mentioned, the agreement with the Cayman Islands.

There are countries where our relations with the law enforcement agencies are not that good, or we have no access to the bank information because of their local laws.

Mr. Wortley. You say the Drug Enforcement Administration has encourage bilateral, mutual legal assistance treaties. Just how helpful have they been in ferreting out money laundering?

Mr. Coward. We don't normally ferret out money launderers, but we use the records available to trace assets from people we have identified as being in drug trafficking.

We are not looking for money launderers per se, but trying to make a criminal case against the drug trafficker or looking for methods to attack the assets.

Mr. Wortley. How effective have these treaties been?

Mr. Coward. The instances where we have used them, the results have been good.

Mr. Trott. In the Cayman Islands, the treaty has been almost 100-percent effective in this sense: We were getting nothing out of them 4 years ago; and if you would have asked me as a law enforcement professional with 17 years under his belt, would we ever get anything out of them, I would have told you I don't think so.

Drug traffickers and other criminals were running all their money through the Cayman Islands. You can't just follow the dope, because you don't get to the people running the organization.

You got to follow the money, so we decided to drag the Bank of Nova Scotia into court in Florida and sue them for the records we wanted. They resisted saying, hey, you are asking us to do something that will make us violate the law in the Cayman Islands; but the courts agreed with us.

The Bank of Nova Scotia deserves considerable credit for getting on the right side of the issue fast. The Brits moved in. The law was changed the law in the Cayman Islands and now the Bank of Nova Scotia is up and running, and helping us out a lot.

Chairman St Germain. Page 19 and 20 of your statement, you comment that requiring reports of all foreign wire transfer of funds of $10,000 or more presents difficult practical problems that may not be justifiable.

We received that same testimony from Mr. Keating from the Treasury last week; did we not? Now, according to books that cite Federal Reserve studies, items written for over $1,000 account for only 5 percent of the total volume of items processed by commercial banks.

Eighty-eight percent of the dollar value; however, so it is unclear what percentage of total volume of wire transfers is over $10,000, or what volume they might represent.

In other words, 5 percent of the total volume of items processed by commercial banks, but 88 percent in terms of dollar value.

Now, my question is, if indeed wholesale payment mechanisms—wholesale mechanisms are deemed as such because they involve large dollar items, according to the Federal Reserve Bank of Atlanta, items written for more than 1,000 accounted for 5 percent of the total volume of items processed by commercial banks, but 88 percent of the dollar value.

That would seem to indicate that the size of these large wire transfers are rather substantial individual transfers; correct?

Mr. Trott. I would think that would be correct.

Chairman St Germain. It seems as though, going back to last week's hearing, wire transfers can be a very integral part of this money laundering scheme. From what was described to us, we should give some consideration to it during the legislative process on it, especially when we are considering amendments. We should have a little input as to the reporting requirements for these wire transfers.

I don't think it is proper to say that there are too many of them for us to look at. What is your reaction, Mr. Saphos?

Mr. Saphos. Mr. Chairman, I agree with you, both in the concept that the wire transfers bear scrutiny, and a scrutiny of wire transfers will reveal conduct which bears investigation; if not, it is just criminal on its face.

I agree with that, and I don't think it is nearly satisfactory to skip that as a crime. What I would suggest, though, and this is something I spent a little time examining, the Congress has already given to the Secretary of the Treasury the authority to require reports concerning wire transfers to be reported to the Secretary of the Treasury.

One of the regulatory schemes that the Secretary came up with last year is a very good idea. The concept was that the Secretary of the Treasury will give notice to financial institutions in a certain region on a certain type of financial institution that for the next period of time, 90 days, you must report to the Secretary of the Treasury all wire transfers received, sent out of the United States or received back in the United States from every Caribbean nation, or whatever.

All wire transfers for the next 90 days or whatever period you wish and whatever group or class of financial institutions you wish to address at that particular time, much like the way the Secretary of the Treasury has the discretion to require the reporting by financial institutions of their exempt list.

With a mechanism then set up by the Secretary of the Treasury to examine that class of wire transfers——

Chairman St Germain. Let me interrupt. How does Treasury determine which geographic area, which institutions or what have you, they will require for that 90-day period?

Mr. Saphos. One of the suggestions I would have to Treasury, is within their own—in their own TFLEC system, they have a lot of valuable data to assist you, and some will tell you what excess currency we have floating around the United States, which shows which areas are receiving more currency today than yesterday or more currency than other areas of the United States.

Another thing is, we can determine from offshore, their returns as reported to the Federal Reserve, which are not private documents, their returns from foreign banks in the United States of money, who is receiving an awful lot now, which needs to be examined.

Using that data, we can determine, for instance, that there appears to be an awful lot of money flowing from San Francisco to Hong Kong this week that bears scrutiny and perhaps criminal investigation.

Chairman St Germain. Thank you.

Mr. Wylie.

Mr. Wylie. I wrote a note here, Mr. Coward, when you were testifying that says a money laundering statute probably wouldn't help too much in enforcement. Did you say that, or did I misunderstand?

Mr. Coward. I certainly don't recall saying it. On the contrary, the proposed bill for a variety of reasons, and I mentioned three in particular, such as making money laundering per se an offense certainly allows for removing from the trafficking scheme a number of people who DEA and IRS are not able to reach with current legislation.

The facilitation part of the pending legislation is good for DEA from a couple of viewpoints. First of all, it allows the smurfing problem to be—to be more frontally addressed and as I mentioned, we would like to see that happen, not only because Smurfs will make nice defendants, but also very good witnesses.

Mr. Wylie. There are numerous forms of money laundering, and criminals are becoming more and more imaginative, and as our law enforcement efforts become more proficient, they figure out better ways to launder money, but you want to be on record this morning saying you think a money laundering statute will be quite helpful to you.

Mr. Coward. No question about that, sir. But we may well be back again next year.

Mr. Wylie. Where do most of the drugs come in from?

Mr. Coward. Depends on the drug, sir. Cocaine is entirely from South America, and there are a variety of trafficking routes. There is a growing incidence of it coming across the Texas border now.

The Caribbean has been sewed up a little bit with all of the heavy emphasis on enforcement in that area. Heroin comes from Southwest Asia principally, accounting for approximately 50 percent of the heroin that comes into the country—Mexico accounting for 38 percent and Southeast Asia the remainder.

And with regard to marijuana, it is neck and neck between Colombia and Mexico with Mexico edging out Colombia just a bit in the marijuana traffic.

Mr. **Wylie**. A big problem is Colombia.

Mr. **Coward**. Yes, the great majority of cocaine hydrochloride is manufactured in Colombia, the raw product is grown in Bolivia and other countries. The laboratory operations are generally in Colombia, but there are exceptions to that.

Mr. **Wylie**. Where do most of the drugs come into?

Mr. **Coward**. Again, traditionally, coming from South America, into Florida. When things heated up a bit down there, we found them moving farther north, particularly with some of the large marijuana shipments, we were seeing the mother ship operations all the way up the east coast, offshore.

With regard to cocaine, whereas we saw very little cocaine coming through Mexico up until the last year or two, we are seeing a greater and greater incidence of that now. Substantial seizures are being made at the Mexican border, or we are making substantial seizures that we are able to tie back through Mexico as a trafficking route.

That is because of the success we have had in the Caribbean area, the Federal enforcement effort, not just DEA.

Mr. **Wylie**. The real help of our efforts would come if we could work out some arrangement with countries like Colombia. How much success have you had with that?

Mr. **Coward**. We work closely with the Colombians. Their resources are limited to a degree, but we have found them extremely cooperative in a number of situations, and we continue to work very closely with them.

Mr. **Wylie**. Are the banks cooperative?

Mr. **Coward**. We have not been that much involved with the banking in Colombia. They are negotiating now for some agreements.

Mr. **Trott**. Their Treasury cooperates with Federal law enforcement, yes. Colombia has done quite a lot in the last few years to assist in this problem.

The Minister of Justice, Mr. Lara Bonilla, was assassinated in Colombia by drug traffickers, and at that point, President Betancur stepped up the program and started to extradite Colombia drug traffickers to the United States to stand trial here in this country for Federal crimes, and they had not done that before.

That has been such a controversial program in Colombia that it resulted in part in an attack on the Colombian Supreme Court, during which many justices of the Colombian Supreme Court and other people were murdered.

When I was there the last time, talking to the new Minister of Justice, I saw written on walls in that city, "Extradition: No."

Nonetheless, President Betancur has continued to cooperate and hauled out the assets of the military in that country. Daily they bomb airstrips that belong to traffickers throughout the country, and they have an eradication program going with respect to marijuana that has been stepped up very much.

Mr. **Wylie**. You also have said that the situation seems to be getting worse.

Mr. **Trott**. When I go to Colombia, and for the lack of a better description, belly up to them and say: "What are you doing about this problem down here?" They remind me that the market is in the United States and they ask what we are doing about the market, and they describe the demand side of the equation as the root of the problem.

They point out, "If your people weren't spending $80 billion a year on this stuff, we wouldn't have our people growing it."

Chairman **St Germain**. It takes two to tango.

Mr. **Wylie**. Thank you, Mr. Chairman.

Chairman **St Germain**. Maybe what we should do is instead of all this controversy about aid to—military aid to Contras, we ought to give more military aid to President Betancur so he can do a little better job on those planes, and airstrips, and what have you.

Mr. **Wylie**. You put that bill in, I will support it.

Chairman **St Germain**. Mr. Coward, the testimony last week was that the smurfs went in and bought all kinds of money orders, cashier's checks, and it was to any Latin name, the payee could be any, they put in any Latin name at all, and then as a payor, USD Co. of Florida, Realty Management Co., et cetera, and that those checks, money orders, that went into an envelope, and that individual took a plane to Colombia.

It is obvious that those transactions, those checks and money orders then are deposited or brought into a financial institution in Colombia, right?

What are the banks in Colombia doing to cooperate? And I thought you said they were cooperating, no problem; but it seems to me, if they had a suspicious reporting requirement, face it, a little envelope can contain a lot of checks and money orders.

Aren't those banks in essence part of the circuit here?

Mr. **Trott**. They are not going to banks.

Mr. **Saphos**. I am sorry. In Colombia, sir? They are going to Colombia. Those negotiable instruments in false names are being treated by the narcotics traffickers in Colombia like specie, like money.

The Colombian cocaine trafficker buys his cocaine paste in Peru, and the Peruvians won't take pesos because of inflation. He uses those moneys to buy cocaine paste. We turn them over and look at the back of that thing, and notice five or six people have had their pseudonym endorse that over to other persons, because it has been used as a negotiable instrument offshore.

It has that made-up name on the face. We are seeing it goes through Panamanian banks, and back into the United States, and the turnover rate between that Panamanian bank and its corresponding bank in the United States.

If my bank in Virginia could do one-tenth as well in turning those things over rapidly, I would be very lucky and my float time would be a lot quicker.

A smurf would buy a check in Los Angeles on a Friday, it was being cleared through the financial institution back in Miami after going overseas and coming back into the United States over a 3-day weekend, 4th of July. That is pretty good work.

That gave the doper the use of the money in Panama, and it gave the institution in the United States the use of the money almost overnight.

Chairman **St Germain**. The Panamanian bank is principally involved as the collecting bank?

Mr. **Saphos**. That particular bank, we seized the assets of that bank in south Florida in the United States. We are litigating the case right now, but we have probable cause to believe that they were acting as a mere conduit for narcotics money——

Chairman **St Germain**. You were able to look at those instruments and you found that the Panamanian bank was involved. Now that that bank has had a hold put on it, as a result of litigation, will you be able to then trace and find out which banks will be utilized?

Mr. **Saphos**. Quite often, by tracking the negotiable instrument itself when it comes back into the United States by obtaining a subpoena for the instruments from the U.S. financial institutions, unfortunately, they have no obligation to keep secret the fact that we are conducting that investigation and have no obligation.

Chairman **St Germain**. If you get all those pseudonyms on there, there ain't no customer.

Mr. **Saphos**. The pseudonym is the name of the payee. No real obligation in the law requires the remitter be disclosed at all. It is a mere convenience.

Chairman **St Germain**. Mr. McCollum.

Mr. **McCollum**. Mr. Trott, I have a couple of questions. This is an area we have talked about many times, but I don't know if we ever nailed down something I discussed last week with Mr. Keating.

Right now, there is a procedure that individual banks file for exemption from reporting requirements under the Bank Secrecy Act. They can take a customer that has a lot of cash normally, grocery store, whatever, that exceeds the amount we would expect somebody to put in there by cash, and put them on an exempt list.

The customer at the present time is not a party to the exemption, he doesn't have to sign anything, request the exemption, an internal thing done for the purposes of the bank, and the Treasury Department.

It was suggested last week, and Mr. Keating seemed to think it was a good idea, that it might be helpful to law enforcement and everybody else involved if the customer were required to sign some kind of a statement at the time the exemption is granted to him indicating the source of cash, the nature of his business, so forth, so that if it turns out later to be false and not true, it might be an easier prosecution than otherwise would be available to law enforcement.

Is it a concept that you think is viable, and would you suggest we pursue it?

Mr. **Trott**. That sounds like a very good idea.

Mr. McCOLLUM. I also have a question relative to your testimony regarding the bill Mr. Torres and the chairman had put in, and I know you have testified to some of this, in your testimony, with regard to the $10,000 reporting requirement, but I didn't see any mention in the testimony, and I apologize for missing this.

I don't believe you have been asked any questions about the $3,000 recordkeeping requirement in that bill as well. The bill calls for the banks to keep records on cash transactions, $3,000 or more, doesn't require that they report all of those, but that they keep certain records.

Do you have a problem with that requirement? Is that a problem for anybody, or should we leave that one alone, too, in your view?

Mr. SAPHOS. That in itself, no, sir.

Mr. McCOLLUM. Would you say that?

Mr. SAPHOS. That in itself, no, I have no problem with that, but we are working with Treasury to come up with what we think might be a better solution, using the same number.

One of the solutions we are working with Treasury on is that it be illegal for anyone to structure a transaction, it is wrong to go to different banks in the same day, same bank on the same day, same bank on multiple days for the purpose of keeping a bank from filing a report.

The problem is that we are now simply telling the bank, if he comes into your bank many times in the same day, then you must report it. We are not addressing the rest of those questions.

The $3,000, the document kept and maintained by the bank concerning $3,000 transactions, can be a significant contributor to that. If we tell the bank, you must report, if your customers comes into you many times in the same day, and has transactions in excess of $10,000, but you must also report if he goes back into your institution and others in the same day, and has transactions in excess of $10,000.

And the way you may learn that is if your customer purchases a negotiable instrument with you for cash in the amount of more than $3,000 or what have you, then he has to fill out an application, and on the application you ask him whether he is structuring his transaction and you are allowed to rely upon that.

We are not trying to make you—the bank—a detective. You are allowed to rely upon his representation to you.

Mr. McCOLLUM. He didn't get stuck. He made a statement that you can prosecute him for.

Mr. SAPHOS. Right. If he lies we can prosecute him.

Mr. McCOLLUM. Same idea I asked about. I like that. I know we are about to vote.

Chairman ST GERMAIN. Let me ask you, on a false statement, Mr. McCollum just asked you about this, if you were to prosecute someone, wouldn't you have to have a signed false statement on record?

Mr. TROTT. A provable false statement, right, and we would try to make it in terms of a document that is signed.

Chairman ST GERMAIN. Do you agree or disagree with that?

Mr. TROTT. That would be a good predicate for a Federal prosecution.

Chairman ST GERMAIN. The requirement?

Mr. **Trott**. Yes.

Chairman **St Germain**. So, you have no problem with that? Who was objecting to it?

Mr. **Wylie**. I don't think anybody was, Mr. Chairman.

Chairman **St Germain**. Hold it a minute. My staff feels that the Treasury already has regulatory authority to require a signed false statement.

Mr. **Trott**. We are working on that with Treasury.

Chairman **St Germain**. The thought was that perhaps there was a bit of a resistance because this would involve a substantial dossier, so to speak; correct?

Mr. **Trott**. Yes, banks would be required to keep additional records. I don't think there is necessarily resistance, but what I do, whenever I am imposing a requirement like this on somebody, I try to ask, is this an unreasonable requirement?

Are we creating so many problems for the banking system that the tail starts to wag the dog so that they can't do anything except fill out reports.

We want to make sure it is balanced and meets the objective without causing too many problems.

Chairman **St Germain**. I find it hard to believe that there are that many people coming in, with those large denominations of cash, that are in a legitimate business, except for the grocery store.

Mr. **Trott**. There are a lot of cash businesses out there. I have heard bankers describe many people you might not otherwise expect.

Chairman **St Germain**. They would be on an exempt list; wouldn't they? The fellow dealing with his or her local bank, if they are recognized.

Mr. **Trott**. That is what the exempt list is created for, you are right.

Chairman **St Germain**. You exempt the legitimate businesses, or the bankers who are very familiar with their local customers.

It seems to me that that volume should not be too great.

Mr. **Wylie**. We have had another excellent session, Mr. Chairman, with three very excellent witnesses, and you have made a very significant contribution, at least as far as this member is concerned. Thank you very much.

Chairman **St Germain**. I, too, want to add my thanks to you. There are a few questions we propounded to you and I would ask— I will have the staff ask the real burning ones, those where we would like the replies as soon as possible, so we have them for the record if we go into a markup session soon.

Mr. **Trott**. Fine.

Chairman **St Germain**. The subcommittee will stand adjourned until the call of the Chair.

[Letters of invitation to witnesses of this day's hearing can be found in the appendix.]

[Whereupon, at 12:45 p.m., the subcommittee adjourned subject to the call of the Chair.]

APPENDIX

Department of Justice

STATEMENT

OF

STEPHEN S. TROTT
ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE

THE

SUBCOMMITTEE OF FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

MONEY LAUNDERING LEGISLATION

ON

APRIL 23, 1986

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Mr. Chairman and Members of the Subcommittee, I am pleased to be here today to present the views of the Department of Justice on one of the biggest problems presently facing law enforcement, the laundering of money derived from criminal activity. Let me say initially that this is a difficult and complex subject as evidenced in part by the large number of bills that have been introduced.

As the Subcommittee knows, money laundering -- the process by which one conceals the existence, illegal source, or illegal application of income and then disguises the source of that income to make it appear legitimate -- is big business. Just how big nobody knows for sure because drug rings and organized crime families do not prepare annual reports, but the Treasury Department has estimated that Americans spend more than $80 billion each year to buy illegal drugs. Sales of $80 billion would make the illegal drug trade a bigger operation than all but one of the Fortune 500 companies, larger even than General Motors. And that is just from drug trafficking. A Wall Street Journal article -- which editorially supported the Administration's money laundering bill that I will be describing in a minute -- contains an estimate that somewhere in the neighborhood of $150 billion is generated each year by drugs, gambling, and vice in general. We ourselves are unable to determine exactly how much is laundered, but obviously it is a multi-billion dollar figure.

The Attorney General summed up the problem when he described money laundering as "the life blood of the drug syndicates and traditional organized crime." Unfortunately, this problem has grown in size and complexity. More people are involved, there is more money being laundered, and the schemes to wash "dirty money" are now often so sophisticated that they involve an intricate web of domestic and foreign bank accounts, shell corporations, and other business entities through which funds are moved by high speed electronic fund transfers.

Perhaps even more disturbing is the increasing willingness of professional persons such as lawyers, accountants, and bankers at all levels from tellers to senior officials to become active participants in money laundering. While some criminal organizations still wash their own illegally generated money by such relatively crude methods as one of their members' smuggling a suitcase full of currency out of the country for deposit in an offshore bank, a number of drug rings and other criminal syndicates now hire professionals to launder the money produced by their operations.

Consequently, this Administration has determined that what is needed is new legislation to directly prohibit the laundering of money. The bills that I will be discussing today would create such an offense. Before I do that, however, I think it would be helpful to review some of their background.

On July 28, 1983, the President established the Commission on Organized Crime. Among other responsibilities, the Commission was charged with making recommendations concerning any legislative changes needed to better combat organized crime and to improve the administration of justice. In October of 1984, the Commission issued an interim report to the President and the

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Attorney General dealing specifically with money laundering. Entitled _The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering_, the report graphically illustrated the problem and set out draft legislation designed to deal with it. The suggested legislation contained a new money laundering offense in Title 18, amendments to the Currency and Foreign Transactions Reporting Act in Title 31, and Amendments to the Right to Financial Privacy Act located in Title 12. [1]

The Department of Justice and the Treasury Department have thoroughly reviewed the proposals drafted by the Commission on Organized Crime and analyzed them in light of our experiences in investigating and prosecuting money laundering cases around the country. While the recommendations of the Commission provided an excellent starting point, we concluded that modifications and refinements were needed in a number of areas, and that certain additional provisions and offenses not discussed by the Commission would also be of great assistance in combatting money launderers. A bill was then prepared by the Departments of Justice and Treasury which in our judgement represents the most effective legislative response to the money laundering problem. Our proposed bill was introduced in the House as H.R. 2785.

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[1] The Commission recommended other measures, such as a new bank bribery statute and an amendment of the federal wiretapping statute (18 U.S.C. 2510 _et seq_.) to allow law enforcement authorities to seek court orders authorizing the interception of communications involving criminal violations of the Currency and Foreign Transactions Reporting Act, which were enacted as part of the Comprehensive Crime Control Act of 1984 (P.L. 98-473). Moreover, a number of its recommended amendments to the Currency and Foreign Transactions Reporting Act, such as greatly increased fine levels and the addition of an attempt provision, were also enacted as part of the Comprehensive Crime Control Act.

In that bill we agree with the Commission that a new offense dealing specifically with money laundering is needed in Title 18 of the United States Code. As the Committee knows, at the present time we do not have such a statute and most prosecutions for this offense are brought under the Bank Secrecy Act provisions in Title 31 that require the filing of various reports concerning certain monetary transactions with financial institutions and which punish the failure to file the reports or to do so truthfully.

That this approach is no longer adequate is vividly illustrated by a recent investigation of large scale money laundering in Puerto Rico. That situation involved a loose network of local financial institutions and illegal lottery ticket dealers known as "acaparadores." The gist of the scheme was that the "acaparadores" would buy winning lottery tickets from legitimate winners of the Puerto Rico lottery for a slight premium plus the value of the tickets. In turn, they would sell these winning tickets for a higher price to "clients" wishing to hide illicit income. While some of the "acaparadores'" conduct was punishable under local law, most of it was not prosecutable under current federal law.

For example, when the "acaparador" accepts substantial amounts of currency from a narcotics trafficker and gives the trafficker a winning lottery ticket, his conduct is not punishable under the Bank Secrecy Act. Before the government can

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prosecute an "acaparador" we would have to establish that he has been operating as a financial institution as this term is defined in the law. More importantly, and certainly more difficult to do, we would have to prove that the "acaparador" knew about the law, that his activity was covered under the law, and that he knew about his obligation to file the necessary reports and to keep records of his transactions. Further, we have no effective law with which to prosecute employees of businesses other than banks because of the necessity of proving that they were acting as employees of a financial institution and that therefore they had the obligation to file the required reports.

Simply put, the Bank Secrecy Act, while an effective law enforcement tool, is not enough, standing alone, to combat money laundering. As long as currency transactions are properly reported, the Bank Secrecy Act contains no sanction for washing dirty money. Consequently we think that a new provision should be added to Title 18 making it an offense to conduct or attempt to conduct a transaction involving monetary instruments or the wire transfer of funds, if the transaction affects interstate or foreign commerce or is conducted through a financial institution the activities of which affect interstate or foreign commerce, provided that the government can show either of the following: first, that the person acted with the intent to promote, manage, establish, carry on, or facilitate an unlawful activity (defined as a state or federal felony), or, second, that the person knew or acted in reckless disregard of the fact that the monetary instruments or funds represent the proceeds of or are derived from the proceeds of an unlawful activity.

We have carefully drafted our bill (HR. 2785) to include not only the person who, for example, deposits cash representing the proceeds of an unlawful drug transaction in a bank or uses such "dirty money" to buy a new car, but also the bank employee or car salesman who participated in the transaction by accepting the money if such a person can be proved to have known or to have acted in reckless disregard of the fact that the money involved was derived from criminal activity. Such persons, and in particular the employees of banks and other financial institutions who knowingly or recklessly help criminals dispose of the fruits of their crimes, facilitate criminal activity and are as deserving of punishment as the drug dealer or loan shark who brings them their ill-gotten cash or other monetary instruments derived from their cash. [2/]

The punishment for the new money laundering offense which we have proposed is appropriately severe: imprisonment for up to twenty years and a fine of up to the greater of $250,000 or twice the amount of money involved in the offense. H.R. 2785 also provides for a civil penalty of up to the greater of $10,000 or

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[2/] H.R. 2785 would not apply to duly authorized government law enforcement or intelligence activities such as FBI undercover operations routinely described in annual appropriations bills. See, e.g., section 203(b) of P.L. 98-411 (98 Stat.1545, 1559).

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the amount involved in the transaction, and for the forfeiture of all funds involved in the offense. The civil penalty and the forfeiture provisions would be in addition to any fine imposed for a criminal conviction. In short, we intend to make the laundering of money derived from criminal activity an expensive proposition for those who would try it.

One aspect of the new money laundering offense which merits particular attention is the coverage of one who cannot be shown to have actual knowledge that the money he or she receives or handles in a transaction was derived from a crime but who acts in "reckless disregard" of the fact that the money was so obtained. Increasingly, with the enormous money derived from narcotics trafficking and organized crime, money launderers are persons such as lawyers and bankers who, for a price, launder money that is clearly the proceeds of a crime even though it cannot be proven that they have actual knowledge of its source.

Consider, for example, an actual case in the Southern District of Florida in 1982: One Beno Ghitis, a foreign national who operated a money exchange business in South America, opened an account in the Capital Bank in Miami in the name of an entity called Sonal. An agent of Ghitis, a person named Victor Eisenstein, deposited $242 million in cash in the Sonal account between January and August of 1981, most of it brought in in cardboard boxes and duffel bags. For handling the Sonal account, the bank charged a "service fee" of 1/8 of 1 percent of the total deposits which was subsequently raised to ½ of 1 percent and then to a flat "fee" of $300,000 per month. In civil forfeiture actions brought against some of the money in the Sonal account and against some found in Eisenstein's office, the District Court found that although there was no indication that any of the principals were engaged in drug transactions, the volume, frequency, and other circumstances surrounding the cash deposits were such that Ghitis, Eisenstein, and others involved knew or should have known that the cash involved was drug tainted. Hence, nearly $8 million was forfeited to the government, $4,255,625.39 in the Sonal account and $3,686,639 (a picture of which was prominently displayed here last week) found in Eisenstein's office which he had conveniently rented in the same building as the branch of the Capital Bank where he made most of his deposits. [3/]

To illustrate it further, take the hypothetical case of an attorney who, for a $50,000 fee, accepts a suitcase containing $500,000 in currency from a person who he knows is employed as a construction worker with instructions to deposit it in small amounts in several different banks in his own name and then wire the money in each of the accounts to the worker's bank account in a foreign country. As another example, consider a bank employee who, for the same ten percent fee, accepts the whole suitcase of cash from the construction laborer, distributes it among several

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[3/] United States v. $4,255,625.39, 551 F. Supp. 314 (S.D. Fla. 1982), aff'd 762 F. 2d 895 (11th Cir. 1985).

accounts set up by the laborer, and then wire transfers it to the foreign Bank.

Most persons would agree that in these examples there is such a substantial risk that the money is derived from a crime that the attorney and the banker are acting reprehensibly in accepting it with "no questions asked." To ignore this risk is to act in reckless disregard of the fact that the money represents the proceeds of a crime. If such a "reckless disregard" standard were not included, persons such as those in the examples I have just described who were willfully blind to the obvious source of the money involved could not be prosecuted.

Accordingly, the term "reckless disregard" is defined in the new money laundering offense as an awareness of facts and circumstances that lead the person to believe that a substantial risk exists that the monetary instruments involved in the transaction represent the proceeds of, or are derived from, an unlawful activity, coupled with his conscious disregard of the risk in a manner that constitutes a gross deviation from the standard of care that a reasonable person would exercise under the circumstances. The term "reckless disregard" is used in at least three other statutes in Title 18 [4] and is to be contrasted sharply with a mere "reason to know" or "negligence" standard which was recommended by the Commission on Organized Crime. After careful consideration, we concluded that a "reason to know" standard was not suitable for subjecting a person to either the serious criminal or civil sanctions set out in the new money laundering offense. [5/]

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[4] See 18 U.S.C. 1365, proscribing the tampering with consumer products; 18 U.S.C. 33, concerning the destruction of motor vehicles; and 18 U.S.C. 1861, prohibiting the deceiving of prospective land purchasers.

Turning now to other provisions in the Administration's bill, Section 7 of H.R. 2785 would add a new criminal facilitation offense to Title 18. It would accomplish this by adding a new Subsection (c) to 18 U.S.C. 2 to provide that

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[5/] In addition to the scienter element, the Department's bill differs in other ways from the proposal drafted by the Organized Crime Commission. First, the Department's bill covers money laundering that affects commerce whereas the Commission's bill was restricted to money laundering through financial institutions. Second, the Department's bill covers money laundering through wire transfers; the Commission's bill does not. Third, the Commission's bill did not contain a forfeiture provision or civil penalties. Fourth, the Commission's bill provides for general extraterritorial jurisdiction over the offense. The Department's bill provides for much more limited extraterritorial jurisdiction. Such jurisdiction would attach only if the the transaction constituting the offense involved the laundering of $10,000 or more derived from a violation of Title 18 or from certain particularly serious offenses in other titles such as those involving drugs, tax evasion, and espionage; the conduct constituting the money laundering was by a United States person, or, if not by a United States person it occurred at least in part in the United States; and the defendant had actual knowledge that the money represented the proceeds of one of the covered types of unlawful activity. The requirement that the defendant have actual knowledge that the money was derived from a crime, as opposed to having acted with reckless disregard of that fact, was added because of a concern that otherwise the new money laundering offense might impose a burden on foreign persons acting abroad to become aware of United States law.

"whoever knowingly facilitates the commission by another person of an offense against the United States by providing assistance that is in fact substantial is punishable as a principal." This offense would not be limited just to money laundering but would be particularly applicable to money launderers. For example, the new offense would be committed by one who, for a fee, took small denomination currency that he knew was derived from drug sales and exchanged it for large, easy to smuggle bills for the dealer to secret out of the country. Although the person took no part in the smuggling and was indifferent as to the source of the money he would facilitate the violation and be guilty as a principal. It would also be committed by a chemist who manufactures and sells a lawful but difficult to obtain ingredient to a person who he knows intends to use it to produce a controlled substance.

In short, one who provides substantial assistance to another in the commission of an offense engages in reprehensible conduct which should subject him to criminal liability as a principal. Yet some courts have held that such a person is not guilty as an aider and abettor under 18 U.S.C. 2(a) unless he consciously intends to make the criminal venture succeed. Other courts have held, however, that a person who knowingly furnishes material assistance such as bribe money or goods to a person who he is aware intends to use them in a crime has sufficient *scienter* for criminal liability under 18 U.S.C. 2.[6] The facilitation offense

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6/ See, for example, *Backun* v. *United States*, 112 F. 2d 635, 637 (4th Cir. 1940) where the court stated that "[g]uilt as an
(Footnote Continued)

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is intended to clarify the case law to ensure that one who knowingly furnishes such assistance to a criminal is punishable.

Section 8 of the bill is also not confined strictly to money laundering but, like Section 7, would be particularly useful in dealing with those who handle "dirty money." It would add a new Section 2322 to Title 18 setting out two related, but distinct, offenses. The first offense is knowingly receiving the proceeds of any federal felony. The offense would be committed, for example, by a money launderer who received the proceeds of any federal crime.

The second offense is bringing into the United States any money or other property which has been obtained in connection with the violation of any law of a foreign country proscribing narcotics trafficking for which the punishment under the foreign law is imprisonment for more than one year. This offense is intended to reach those foreign drug traffickers who would look to the United States as a place in which to invest their illegal profits and to insure that the United States does not become a haven for such activity.

It is interesting to note that both Canada and Switzerland have analogous provisions in their laws. Just recently in

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(Footnote Continued)
accessory depends, not on 'having a stake' in the outcome of crime ... but on aiding and assisting the perpetrators; and those who make a profit by furnishing to criminals, whether by sale or otherwise, the means to carry on their nefarious undertakings aid them just as truly as if they were actual partners with them having a stake in the fruits of their enterprise."

Switzerland, three men were convicted and jailed for laundering $47 million obtained from heroin sales in United States pizza parlors. The scheme involved some 500 people in Switzerland, New York, Italy, and Turkey, who sold some $1.65 billion worth of heroin through the so-called "pizza connection." The sentences imposed ranged from two to 13 years, and the men were fined a total of $82,000.

Section nine of our bill sets out a new Chapter 202 in Title 18 dealing with criminal and civil forfeitures. (It is drafted in such a way that is is easily modifiable if at some later time the Congress thought another Title 18 offense ought to have a forfeiture remedy). It provides for the civil forfeiture of all funds or monetary instruments involved in the violation of the money laundering offense, and of the receiving proceeds offense if the proceeds were obtained in violation of either a federal or foreign felony provision pertaining to controlled substances. The provisions for accomplishing civil forfeitures are patterned after the civil forfeiture provisions in Title 21. The new chapter also provides for the criminal forfeiture of money or other property involved in a violation of the money laundering or receiving proceeds offense. Criminal forfeiture would apply to any violation of the new receiving proceeds offense, not just the receiving of money or property derived from a drug crime.

In addition to setting out new offenses and other sanctions, H.R. 2785 also contains several provisions designed to make easier the investigation of money laundering and the tracing of the proceeds of crime. These amendments generally concern the

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Currency and Foreign Transactions Reporting Act in Title 31 and the Right to Financial Privacy Act in Title 12 and were addressed by Mr. Keating, from Treasury, last week. However, I would point out that H.R. 2785 contains a procedural provision in Section 4 that is a matter of concern to this Committee. Section 4 essentially complements the amendments to the Right to Financial Privacy Act made in section three.

Section 3 would amend the Right to Financial Privacy Act to define and clarify further the extent to which financial institutions may cooperate with federal law enforcement authorities in providing information which is relevant to crimes by or against financial institutions, violations of the Bank Secrecy Act in Title 31, [7/] violations of the new money laundering offense, and violations of certain serious drug crimes. The effect of this amendment to the RFPA is to allow a bank or other financial institution to provide information which it has reason to believe may be relevant to one of these crimes without risking civil liability under the Act or entailing any obligation to notify the customer of such cooperation which the Act requires. The bill also provides for preemption of this field, thus avoiding the possibility of a bank employee incurring in civil or even criminal liability under a more strict state

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[7/] The Bank Secrecy Act includes the Currency and Foreign Transactions Reporting Act. The CFTRA was enacted as Title II of P.L. 91-508 and is now codified at 31 U.S.C. 5311-5322. Together with Title I of P.L. 91-508, it is commonly called the Bank Secrecy Act.

statute, for cooperating with federal law enforcement authorities.

Section 4 contains an analogous provision that would amend Rule 17(c) of the Federal Rules of Criminal Procedure to clarify the authority of the United States District Courts to issue orders commanding a person to whom a subpoena duces tecum is directed not to notify, for a specified period, any other person of the existence of the subpoena. Like the amendment to the Right to Financial Privacy Act negating the financial institution's obligation in certain situations to notify the customer that it has provided evidence of crime to law enforcement authorities, this provision is intended to prevent disclosure by third party record holders, such as banks, of legitimate law enforcement interest in the records subpoenaed by a grand jury. Such premature disclosure obviously has a high potential for impairing the investigation and should not be tolerated.

I would now like to address some features of the money laundering and related provisions in other bills pending before the Committee.

Let me turn first to H.R. 1367 and to H.R. 1945. H.R. 1367 sets out the new money laundering offense recommended by the President's Commission on Organized Crime as Title I, and H.P. 1945 makes only minor stylistic changes in this approach which it sets out as Title II. [8] While our bill is derived in part from this approach, as I have indicated there are significant differences.

First, the money laundering offense in H.R. 1367 and 1945 would be limited to money laundering through financial institutions. That is too restrictive as it would not reach money laundering by such methods as directly purchasing businesses, real estate, jewelry, etc. Nor would it help in an actual case which I can describe only generally because certain aspects of it are unresolved. In this case an attorney, whose clients were drug traffickers who generated large amounts of cash, hired a private investigator to receive, hold, and distribute the cash at the attorney's direction. In fact, well over $1,000,000 of this money was handled by the investigator in a six month period. Some of it was used to acquire boats, aircraft, and real estate and to make improvements to this property. In our view, the new money laundering offense should be applicable to cases such as

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[8] These are the only changes in Title 18 set out in the two bills with the exception of Title III of H.R. 1367 which amends part of the federal wiretap statute (18 U.S.C. 2516). This Title in H.R. 1367 would make the new money laundering offense one which could be investigated by the use of court-ordered interceptions of communications. A similar provision is in section six of the Administration's bill which also makes the new money laundering offense a predicate offense for the ITAR statute (18 U.S.C. 1953) and a RICO predicate (18 U.S.C. 1961). Moreover, Title III of H.R. 1367 would make a now-unnecessary change in 18 U.S.C. 2516 by making a violation of 31 U.S.C. 5322 concerning the failure to file currency transaction reports an offense which may be investigated by court-ordered wiretaps. Such a change was made by Section 1203(c) of P.L. 98-473 (The Comprehensive Crime Control Act of 1984).

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this even though a financial institution was not involved. Accordingly, the money laundering offense in the Administration's bill, would apply whenever the transaction involving the proceeds of a crime can be shown to affect interstate or foreign commerce or to be conducted through a financial institution which is engaged in or the activities of which affect interstate commerce.

Second, as I have already discussed, the *scienter* standard in H.R. 1367 and H.R. 1945 is too broad. These bills would punish one who was merely negligent in engaging in a transaction involving the proceeds of a crime. Although negligence in this area is certainly reprehensible, we think criminal liability should be reserved for persons who had actual knowledge that the funds involved were derived from a crime or who acted in reckless disregard of that fact.

Third, H.R. 1367 and H.R. 1945 would only proscribe the laundering of money derived from certain listed federal felonies. While the list is long and cover offenses most likely to produce "dirty money" -- it closely follows the list of crimes that are predicate offenses for the RICO statute, 18 U.S.C. 1961 -- we can see no valid reason to limit the offense to laundering money derived from these crimes while not covering money derived from such heinous federal offenses as Presidential assassination and espionage, and such state offenses as gambling and prostitution. In short, we would prefer the new money laundering offense to cover the proceeds of any federal or state felony.

Fourth, H.R. 1367 and H.R. 1945 describe the offense as conducting "a transaction or series of transactions." The

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Administration's bill eliminates the reference to a "series of transactions" because such a phrase makes the inclusion of multiple counts in an indictment more difficult and may allow certain money launderers to escape deserved punishment by casting several different crimes as but one.

Fifth, the Administration's bill, would reach money laundering through wire transfers, whereas H.R. 1367 and H.R. 1945 would not. This is a potentially serious omission in light of the use of wire transfers in sending unlawfully obtained money out of the country and returning it thereafter.

Finally, the Administration's bill contains forfeiture and civil penalty provisions while H.R. 1367 and H.R. 1945 do not.

Turning now to H.R. 1474, this bill also provides, in Section 2, for a new money laundering offense in Title 18. It would proscribe the engaging or attempting to "engage in a financial transaction in criminally derived property." In our view, this provision suffers from some of the same problems as are found in the money laundering provisions in H.R. 1367 and H.R. 1945. The offense would be limited to laundering money through financial institutions which are too restrictive because it excludes money laundering through other types of businesses. Moreover, the definition of "financial transactions" limits the term to "the deposit, withdrawal, transfer, or exchange of funds or a monetary instrument, (as defined for the purposes of subchapter II of Chapter 53 of Title 31) by, through, or to a financial institution." This may well exclude such transactions as the purchase of stock in a bank, or the placing of funds in escrow as collateral for a loan, both of which are possible ways to launder money. In addition, the offense would be limited to laundering money derived from offenses that are predicate offenses for a violation of the RICO statute. As mentioned previously, this may well cover most common offenses that generate "dirty money," but it leaves out some others that should be included.

Sections 3 through 6 of H.R. 1474 make changes in the Bank Secrecy Act in Title 31. Sections 3, 4, and 5, are of primary concern to the Treasury Department but I would briefly note that Section 3 would amend 31 U.S.C. §5318 to provide that exemptions to the reporting requirements under the Bank Secrecy Act must be approved by the Secretary of the Treasury. Under current law the banks themselves may grant exemptions. Section 4 would amend 31 U.S.C. §5316(a)(1) to require the reporting to the Treasury Department of wire of electronic fund transfers of $10,000 or more into or out of the United States. The present law only requires the reporting of the transporting of monetary instruments into or out of the United States and does not reach electronic fund transfers. Section 5 would amend Section 5318 of Title 31 to require the bank supervisory agencies to which the Secretary of Treasury has delegated duties and powers under the Bank Secrecy Act to look for violations of that Act every time they make a regular audit or inspection.

We have no objection to these provisions on their face although it is our understanding that requiring reports of all

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foreign wire transfers of funds of $10,000 or more would present difficult practical problems that may not be justified. However, we think that even greater changes in the Bank Secrecy Act are needed than those in Sections 3 through 5 of H.R. 1474. Specifically, we believe that the Secretary of the Treasury should be given authority to issue a summons to financial institutions or persons having custody of the records required to be kept under the Bank Secrecy Act requiring them to give testimony and to produce documents relevant to the civil enforcement of the Act. Moreover, as stated before, the Act needs to be revised to allow the Treasury Department to share more efficiently the information it obtains in reports filed under the Act with other federal and state law enforcement agencies, to increase civil penalties for violations of the Act, and to clarify the definitions of certain terms used in the Act. In short, the Administration favors the more comprehensive approach taken in its bill to the provisions in Sections 3 through 5 of H.R. 1474 and to the Title 31 amendments made in H.R. 1367 and H.R. 1945.

As for Section 6 of H.R. 1474, this section is now unnecessary. Prior to the passage of the Comprehensive Crime Control Act of 1984, 31 U.S.C. §5316(a) punished one who "transports or has transported monetary instruments" of a certain amount into or out of the United States without filing a

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report. [9] There was no attempt provision and the prosecution of persons discovered with large amounts of undeclared currency about to board departing international flights was often difficult. Courts had drawn fine lines as to the particular point at which the provision was violated, with some holding that no violation could be found until the person with the currency was on the verge of boarding the plane or other mode of transportation at the final call for departure (at which point apprehension was often difficult) even though the person had falsely stated to a Customs Officer some time earlier that he was not transporting more than the reportable amount. Section 901(c) of the Comprehensive Crime Control Act added an attempt provision to 31 U.S.C. §5316(a), thus overcoming this problem.

Section 6 of H.R. 1474 would replace the new attempt provision and make the subsection reach one who "transports, is about to transport, or has transported" unreported monetary instruments of $10,000 or more. In our view, while such a change would probably not lessen our ability to reach the conduct now covered by the attempt provision, it is simply not necessary to replace this provision, which sets out a familiar concept applied in a number of circumstances, with the unique phrase "about to transport" which may well cause needless litigation.

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[9] Under the old law, reports were required whenever a person transported $5,000 or more. The Comprehensive Crime Control Act raised the amount for which reports would be required to $10,000 or more.

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I would also like to point out, Mr. Chairman that in spite of the successes that United States law enforcement agencies have achieved in the war against drug trafficking and its close partner in crime, money laundering, through the use of the Bank Secrecy Act, its inherent limitations and the limitations imposed by some provisions of the Right to Financial Privacy Act, were such that we are falling short in providing law enforcement with the right weapons to use against money laundering. Recent appellate court decisions have dealt a severe blow to our efforts in using the reporting requirements of the Bank Secrecy Act to identify money launderers. The United States v. Anzalone decision by the United States Court of Appeals for the First Circuit issued July 1, 1985, (766 F.2d 676) reversed a conviction based on the government's theory of the illegality of "structuring" separate currency transactions of less than $10,000 to defeat the filing requirements of the Bank Secrecy Act. "Structuring" as used by the government in criminal prosecutions under Title 31 of the United States Code, consists of breaking up a single currency transaction of more than $10,000 into separate smaller transactions in order not to trigger the CTR filing requirements.

More recently, two other Courts of Appeals and one District Court have partially or entirely followed in the First Circuit's footsteps and reversed convictions for "structuring." 10/ All

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10/ See attached list of cases with a short summary of the Court's ruling.

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of our efforts at curbing what we believe to be illegal activity otherwise known as "smurfing" have either been wounded, or killed, by these decisions.

The Administration is trying to diminish the devastating effects of these adverse court decisions by effectuating changes to the applicable regulations to bring them within the framework of what would be allowed under the court decisions. However, even if certain regulatory changes went into effect tomorrow, the fact remains that the Bank Secrecy Act and its regulations, with all the possible feasible amendments, would fall short of giving law enforcement the effective tools it needs to combat money laundering. There is only so much we can do by regulation to prevent structuring without imposing undue burdens on the overwhelming majority of innocent people. You should not be misled by the success stories you have heard about dealing with effective prosecutions under the Bank Secrecy Act, into believing that the Act is a totally effective tool against money laundering. There are many forms of money laundering which are not covered and possibly could never be covered by the Bank Secrecy Act even if further amended. Criminals are very imaginative in circumventing even the best drawn regulations.

Bills introduced on April 15, 1986 by Congressman Pickle, H.R. 4573, and its Senate counterpart, S. 2306, by Senator D'Amato are also attempts to deal with the problem of "smurfing" or the structuring of monetary transactions by bringing it with the legal framework set by the recent court decisions pointed to

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above. Subject to some technical changes [11/] we endorse these legislative proposals particularly as they pertain to the problem of "structuring." However, they should not be perceived as alternatives to H.R. 2785. These proposals, as they amend Title 31, would only solve the problem as it pertains to the reporting requirements of that Title, which at this moment are needed changes. However, we need a basic money laundering offense that will punish the dealing with proceeds derived from all federal and state crimes as contemplated in H.R. 2785.

I would finally like to comment briefly on H.R. 4280. Section 2(a) of the bill without any apparent motive eliminates the discretion granted by the Bank Secrecy Act to the Treasury Secretary to establish the monetary amount above which a CTR has to be filed. Presently that amount is established by regulation at $10,000 or more. However, the Secretary has the discretion to, if found to be necessary, lower that amount to cover the reality of the market place. As stated by Mr. Keating last week, several ideas are presently being considered to use this discretion granted by statute, to deal with the "structuring" problem until a more permanent solution may be obtained with the passage of H.R. 2785. H.R. 4280 would totally eliminate that possibility by setting the amount, above which a CTR must be

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[11/] At present the Department of Justice and the Treasury Department are working out these technical changes with the purpose of arriving at the most efficient statutory language.

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filed, at $10,000 or more, by law. The Department of Justice does not favor enactment of H.R. 4280.

In sum, Mr. Chairman, while we appreciate the introduction of bills such as H.R. 1367 and H.R. 1945, which by and large contain recommendations of the Organized Crime Commission, as well as H.R. 1474, and H.R. 4573 we believe that our study of all of these bills and intensive consultation with all concerned federal agencies have enabled us to produce the type of comprehensive legislation that is needed in this area. We hope that H.R. 2785 will be carefully considered and then expeditiously processed.

Mr. Chairman, that concludes my prepared statement and I would be happy to answer any questions at this time.

Recent case law on "structuring" of currency transactions

United States v. Varbel, et al.; 9th Cir., Jan. 10, 1986, 780 F.2d 758.

The Reporting Act (Bank Secrecy Act, Title 31 U.S.C. §5312 et seq.) and its regulations did not impose a duty on appellants to inform the bank involved (in the handling of what the government claimed were structured transactions) of the nature of their currency transaction. The reporting obligation is clearly on the bank and the bank not knowing of the nature of the transaction did not have any obligation to report it. No crime was commmitted thus appellants could nto aid and abet or cause anyone to commit an offense against the United States.

United States v. Ronderos; 9th Cir., February 10, 1986, 781 F.2d 1432

"Based on our recent decision in U.S. v. Varbel, (supra) where each currency transaction involves less than $10,000, there can be no conspiracy under 18 U.S.C. §371 to violate Section 5313, since the individual transaction involved were perfectly legal."

United States v. Denemark; 11th Cir., Jan. 16, 1986, 779 F.2d 1559

Defendant could not be convicted under 18 U.S.C. §1001 for causing financial institutions to fail to file currency transaction reports where there were no currency transactions in excess of $10,000 which would require financial institutions to file reports, even though relevant statutes were subsequently amended in a manner which could be construed as making his conduct of purchasing 14 cashiers checks in amounts of $9,900 from 14 different banks criminal. The decision leaves open the possibility that conducting those transactions at the same bank, at least the same day, would be unlawful in that Circuit, unlike the First or the Ninth.

U.S. v. Robert C. Cogswell and David P. Schwindt; N.D. of Cal.; Cr. 85-646, decided November 19, 1985, __________F. Supp._____.

"Because this court finds that the Reporting Act (Bank Secrecy Act, Title 31 U.S.C. §5312, et seq.) does not impose a duty to report transactions in amounts under $10,000 it also finds that the defendants cannot be prosecuted for concealing material facts, because the defendants had no legal duty to disclose any facts." (Parentheses ours)

U.S. Department of Justice

Drug Enforcement Administration

Washington, D.C. 20537

STATEMENT

OF

ALWIN C. COWARD

ACTING DEPUTY ASSISTANT ADMINISTRATOR
OFFICE OF INTELLIGENCE

DRUG ENFORCEMENT ADMINISTRATION
U.S. DEPARTMENT OF JUSTICE

on

MONEY LAUNDERING

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,
REGULATIONS AND INSURANCE
U.S. HOUSE OF REPRESENTATIVES

FERNAND J. ST GERMAIN, CHAIRMAN

APRIL 23, 1986

Chairman St. Germain, Members of the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance: I am pleased to appear before you today to discuss drug trafficking and money laundering.

Before describing the Drug Enforcement Administration's role in money laundering investigations, I would like to briefly explain DEA's role in drug law enforcement.

The Drug Enforcement Administration is responsible for the investigation of violations of the controlled substances laws, targetting major violators who operate at interstate and international levels. DEA also manages a national narcotics intelligence system in cooperation with Federal, State, local and foreign officials and is responsible for ensuring that legitimately produced pharmaceutical products are not diverted into the illegal drug market. Our criminal investigators and diversion investigators work in offices in the United States and in countries overseas.

In addition, DEA assists and supports other Federal, State, and local agencies and foreign governments with training, crop eradication programs and other non-enforcement programs designed to reduce the availability of illicit drugs. Under the policy guidance of the Secretary of State and U.S. Ambassadors, DEA shares responsibility for all programs associated with drug law enforcement counterparts in foreign countries.

The Drug Enforcement Administration acts as liaison with the United Nations, Interpol, and other organizations on matters relating to international narcotics control programs. DEA works closely with the State Department on international liaison, and with the Federal Bureau of Investigation, the Customs Service, the Coast Guard, and several other Federal agencies on a variety of national and international initiatives, including the seizure and forfeiture of assets derived from, traceable to, or intended to be used for illicit drug trafficking.

Today's drug traffickers are truly international entrepreneurs and, because of this, international cooperation in investigating cases, obtaining evidence, and coordinating prosecutions is crucial to DEA and Justice Department enforcement efforts. DEA has encouraged bilateral mutual legal assistance treaties, other bilateral agreements, and a number of other cooperative arrangements to provide us with better intelligence and with evidence which might otherwise be unavailable because of bank secrecy laws.

As you have requested, I would now like to expand on the subject of money laundering of drug profits and the Federal Government's seizure and forfeiture of drug assets.

Seizure and Forfeiture of Assets

Financial investigations leading to the seizure and forfeiture of assets are a crucial part of narcotics enforcement. The Comprehensive Crime Control Act of 1984, makes seizure and forfeiture of the profits and assets generated by trafficking in narcotics important weapons in the government's war on drugs.

Because of the enormous profits being reaped by drug traffickers today, the Drug Enforcement Administration has greatly increased its emphasis on programs to separate traffickers from their ill-gotten gains. Experience has shown that regardless of the size of an illegal drug operation, the arrest of an organization's members--or even its leaders--will not necessarily put the operation out of business. There are always associates, lieutenants, or family members ready to continue operations while the boss is in jail--and the boss may even be calling the shots from behind bars.

But, when DEA seizes all of the property belonging to the leaders of one of these drug operations, the organization is rendered impotent. Whenever we can, we take their cars, airplanes, bank accounts, homes, ranches, racehorses, businesses, stocks and bonds, and everything else that can be legally forfeited to the government.

DEA, the Federal Bureau of Investigation, the Internal Revenue Service, the U.S. Marshals Service, the Organized Crime Drug Enforcement Task Forces, and the Criminal Division of the Department of Justice all cooperate in tracing drug assets and in the use of criminal and civil forfeiture laws, currency and tax laws, and international agreements against tax evasion and money laundering.

DEA and the FBI often initiate the tracing of money and property, and the Internal Revenue Service identifies and investigates individuals who derive substantial income from narcotics trafficking. IRS agents also assist in tracing the movement of funds and the acquisition of assets and they investigate violations of the Bank Secrecy Act, which has criminal penalties for financial institutions and officials who intentionally fail to file or falsify the necessary reporting forms.

Seized cash and the proceeds received from auctioning seized and forfeited property are generally turned over to the U.S. Marshals Service, through its National Asset Seizure and Forfeiture Program, for deposit in the DOJ Asset Forfeiture Fund. Federal law enforcement agencies often use the cars, boats and aircrafts for future law enforcement operations, and state and local agencies frequently share pro rata in all of the assets seized in a cooperative investigation.

In FY-1985, DEA seized cash and other property valued in excess of $250 million and we plan to do more. We are forming and training specialized teams of agents and analysts in many of our division offices--supplemented in some cases by IRS agents and state and local officers. These teams review all of the cases developed in their offices; they identify property, locate it, determine legal ownership, and work with United States Attorneys to effect ultimate forfeiture. The prototype asset removal team in our San Diego office has had outstanding success. As this technique is implemented elsewhere, DEA looks forward to substantial increases in nationwide asset removals.

But while DEA is pleased with the progress of its asset removal program, we are also anticipating that our success will create other problems--in particular, an increase in trafficker efforts to hide assets and launder money.

Money Laundering

The more sophisticated drug trafficking organizations have laundered money for years. In some cases, they purchase service-oriented businesses which are losing money and then deposit their drug money in the bank under the guise of legitimate business profits. They sometimes smuggle enormous amounts of currency out of the country for deposit in foreign banks.

Then, to get their money back to the United States where they can use it, traffickers might set up a phony corporation in still another country. This offshore shell corporation draws on the funds deposited in the first country and wire transfers them to the traffickers' U.S. bank accounts, with the transactions disguised as legitimate loans. Or, using the simplest approach of all, traffickers can bribe a dishonest bank employee to let them deposit unlimited cash without any CTR's being filed.

To give you just a few examples of how successful these enterprises can be, consider money launderer Eduardo Orozco, who was convicted, along with half a dozen others, in May 1983 on drug conspiracy charges. Over a four-year period, Orozco deposited $150 million in cash in some 18 bank and currency exchange accounts, mostly in New York City. He then transferred these funds to other accounts in the U.S., Panama, the Bahamas and the Cayman Islands. Orozco was a well-educated, sophisticated, highly intelligent professional, with all the trappings of a legitimate businessman.

In a 1983 Miami conspiracy case, DEA arrested 36 individuals, two of whom were bank officials--a vice president of the Great American Bank and a vice president of the Bank of Miami. The defendants had negotiated with undercover DEA agents to recruit clients for money laundering and investment services. Approximately $45 million in drug money had been laundered through these banks for various cocaine traffickers.

In another case, Isaac Kattan was arrested by DEA in February 1981. He had on him at the time $18,000 in cash and $365,000 in checks. The next day search warrants were executed and a bank account worth almost $1 million was seized, along with an international telex machine, several money counting machines, and thousands of financial documents. Analysis of the seized documents showed that Kattan's organization had handled gross proceeds estimated at $200-$250 million per year. During the four-month period prior to Kattan's arrest, his two money couriers transported $61 million in cash to a brokerage firm. This money was the

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proceeds from cocaine sales in New York, Los Angeles, and Miami and movement of the funds was facilitated by Kattan's travel agency in Cali, Colombia, which was also licensed to conduct business as a money exchange.

These examples are dated for obvious reasons. There are certainly many more among our still-open investigations.

Our agents, acting undercover, are being approached on a routine basis by traffickers who are looking to launder enormous sums of money. Traffickers have claimed to have as much as $200 million to launder and we can easily suspect that if they have $200 million to place with one money launderer, there is even more being handled by others. Rarely do these people put all of their eggs in one basket.

To cope with these approaches to our undercover agents, DEA has developed techniques designed to ultimately forfeit as much as possible of these monies to the government. However, it would be inappropriate to discuss the details of these investigative approaches in open session.

As DEA becomes more and more proficient at locating and seizing drug trafficker assets and seeing these assets forfeited to the government, two things are likely to happen. First, traffickers will go to greater lengths to move their profits out of the country; and second, they will develop more and more complex schemes to launder their money. Our investigative techniques and our laws must stay one step ahead if we are to have any truly meaningful impact on the availability of drugs in this country.

Mr. Chairman, I appreciate this Subcommittee's interest in the role of money laundering in drug trafficking. I will be pleased to answer any questions you may have.

Thank you.

FERNAND J ST GERMAIN RHODE ISLAND CHAIRMAN
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OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

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STEVE BARTLETT TEXAS
TOBY ROTH WISCONSIN

April 17, 1986

Mr. Jack C. Lawn
Administrator
Drug Enforcement Administration
1405 Eye Street, N.W.
Washington, D.C. 20537

Dear Mr. Lawn:

On April 23, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will continue its hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity.

As the lead Federal agency in enforcing narcotics and controlled substances laws and regulations and whose primary responsibilities include investigation of major narcotics violators (interstate and international), your testimony would be extremely helpful to the Subcommittee in its efforts to better understand the devastating effects that drug trafficking and money laundering have on the economic and social fabric of this nation.

It is requested that you or your designee appear and testify before the Subcommittee on Wednesday, April 23, 1986, at 10:00 a.m., in Room 2128 Rayburn House Office Building.

Please provide the Subcommittee with 175 copies of your testimony no later than 24 hours in advance of your appearance. Please have your staff contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Fernand J. St Germain
Chairman

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SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
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TOBY ROTH WISCONSIN

April 17, 1986

The Honorable Edwin Meese III
Attorney General of the United States
Department of Justice
Washington, D.C. 20530

Dear Mr. Attorney General:

On April 23, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will continue its hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity.

As part of these hearings, the Subcommittee will conduct hearings on the several bills dealing with money laundering, including the Administration's bill, HR 2785. The other bills the Subcommittee intends to review are: HR 1367 (Mr. McCollum), HR 1945 (Mr. Hubbard), HR 1474 (Mr. Hughes), HR 3892 (Mr. Wortley), HR 4280 (Mr. Torres), and HR 4573 (Mr. Pickle).

The Subcommittee would appreciate the Department's analysis of these various proposals, and it is requested that Mr. Stephen S. Trott, Assistant Attorney General for the Criminal Division, appear and testify before the Subcommittee to discuss these matters on April 23, 1986, at 10:00 a.m. in Room 2128 Rayburn House Office Building.

In addition to the bills mentioned above, there are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

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The Subcommittee would appreciate any comments or opinions which the Department might have with respect to the aforementioned Titles that you believe would provide guidance to us in these matters.

Please provide the Subcommittee with 175 copies of Mr. Trott's testimony no later than 24 hours in advance of his appearance. Please have your staff contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Chairman

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U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

May 8, 1986

Mr. Stephen S. Trott
Assistant Attorney General
Criminal Division
Department of Justice
Washington, D.C. 20530

Dear Mr. Trott:

The Subcommittee appreciates your appearance at our hearings on April 23. Your testimony is of great assistance in our review of the Bank Secrecy Act and other pertinent issues.

There are several questions which the Subcommittee would like to have you answer and which will be submitted for the record. They are as follows:

1. What is the justification for eliminating customer notification requirements under the Right to Financial Privacy Act when interagency transfers of financial records are obtained?

2. The Department has had some recent setbacks regarding prosecutions in "structuring" cases. Wouldn't the Pickle bill, H.R. 4573, resolve those difficulties?

3. The Department already has an arsenal of primary offenses utilized in Title 31 prosecutions, such as false bank entries, defrauding the U.S., RICO, Title 26 offenses, Title 21 offenses, etc. Why is it necessary to create a new criminal offense?

4. Under current regulations, the CTR filing duties are placed solely upon the financial institution, not the customer. Wouldn't placing a duty also on the customer to file or to sign a sworn statement be an additional effective law enforcement tool?

5. Why do you feel Treasury needs summons authority? Specifically, what are they precluded from doing now under existing authority?

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6. It is my understanding that the offense of money laundering created in the Administration's bill is not limited to cash transactions through financial institutions, but would cover any transaction involving the movement of funds that affects interstate commerce, whether or not it involves a financial institution, and which is conducted with the intent to facilitate any unlawful activity or with the knowledge or reckless disregard of the fact that the funds were derived from illegal activity.

   (a) What is meant by "any unlawful activity"?

   (b) Is the standard "reckless disregard" an appropriate standard for criminal liability -- especially for this offense?

   (c) Does this extremely expansive definition give you pause to consider what ultimate effect such a sweeping criminal statute could have on protected constitutional rights and what effect such a statute would have on the rights of individual states to administer their criminal laws?

7. As you know, the Right to Financial Privacy Act of 1978 (RFPA) was passed, in large part, as a result of the Supreme Court's decision in United States v. Miller. The Court held that citizens had no property or privacy interest in their bank records. The Act, in effect, overturned that decision.

   At present, there is a move to substantially amend RFPA because it is claimed by some that current law has created clear impediments to criminal law enforcement efforts. Has RFPA created clear impediments to criminal law enforcement efforts and, if so, please explain.

8. In testimony before the Subcommittee, Mr. Richard Wassenaar, Assistant Commissioner, Criminal Investigation, IRS, testified that during 1985 the IRS recommended prosecution of 137 cases involving money laundering. How many of these recommendations were pursued by the Department of Justice? What is the current status of these cases?

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9. The Banking Committee received a letter from Mr. Frederick B. Lacey, Chairman, Advisory Committee on the Federal Rules of Criminal Procedure of the Judicial Conference of the United States, a copy of which is attached. Mr. Lacey states that "with regard to grand jury subpoenas for financial records, the Right to Financial Privacy Act of 1978 ... has created doubt concerning the courts' power." He cites two provisions of RFPA, one which permits a delay in notifying the customer that a subpoena has been served on a financial institution, and the other provision which exempts grand jury subpoenas and related court orders from the Act. Do you share Mr. Lacey's concern?

Again, the Subcommittee is appreciative of your efforts in this area. Please submit your responses to the Subcommittee no later than May 23, 1986.

Sincerely,

Fernand J. St Germain
Chairman

U.S. Department of Justice

Criminal Division

Assistant Attorney General

Washington, D.C. 20530

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MAY 28 1986
Subcommittee on Financial Institutions

The Honorable Fernand J. St Germain
Chairman, Subcommittee on Financial
Institutions Supervision, Regulation
and Insurance
Committee on Banking, Finance
and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Congressman St Germain:

In response to your letter of May 8, I am enclosing responses to the questions you posed by way of follow-up to my April 23 testimony on money laundering.

On behalf of the law enforcement community, I wish to express our profound appreciation for the deep interest you have shown in strengthening federal laws related to money laundering. I believe this is the most important criminal justice legislative issue before the Congress and am thus eager to supply any support and assistance you may require as you examine this vital law enforcement issue.

Sincerely,

Stephen S. Trott
Assistant Attorney General
Criminal Division

Enclosure

Question 1: What is the justification for eliminating customer notification requirements under the Right to Financial Privacy Act when interagency transfers of financial records are obtained?

Answer:

Our justification is basically practical necessity. Notice to a potential criminal defendant that he or she is under investigation is something which must be avoided at all costs in the early stages of an investigation to avoid flight from prosecution, tampering with evidence not yet in the possession of the government, subornation of perjury and other acts which are, in themselves, discrete criminal offenses. In short, notice that a person is under criminal investigation often results in the commission of further crimes.

While the RFPA does provide a judicial procedure for delay of notice, our experience is that this procedure is simply unworkable in practice. In this regard, federal prosecutors receive literally tens of thousands of referrals each year from federal, state and local agencies, private organizations and citizens. Only those involving crimes by or involving financial institutions detected by a federal agency entail the prospect that, but for the entry of a judicial order delaying notice, the putative defendent will be notified, within 14 days of the transfer of records, that he is under investigation. At the early stages of an investigation, prosecutors usually do not have sufficient information to determine whether the referral merits prosecution, much less to provide a court with evidence that notice would result in flight or one of the other bases for delay of notice specified in 12 U.S.C. 3409(a)(3). Finally, even if all of this information were available, the paperwork required to prepare and file an application for delay of notice and then to renew that order every ninety days (criminal investigations, particularly in "paper" cases, frequently require over six months to complete) result in such a drain on our resources as to make the matter not worth pursuing.

For these reasons, federal agencies rarely transfer financial records in connection with referrals of criminal violations. While it may be felt, from a privacy standpoint, that this is a desirable result, we believe that it probably results in declination of some worthwhile referrals because prosecutors do not have access to all available evidence. Even where the case is pursued, the restraints upon interagency transfer of financial records can result in substantially delaying the prosecution; your overnight

(Answer to question 1 continued)

hearings on the Golden Pacific National Bank case captured a classic example of an investigation which dragged on far longer that it should have, in part because of problems in getting information from the Office of the Comptroller of the Currency to the Department of Justice. We believe that the basic purpose of the interagency transfer restriction was twofold: (1) Congressional concern over the compilation of "data banks" which would include, in some central computer, all information in the possession of the Federal Government with respect to citizens, and (2) a view that it would somehow be unfair for the government to obtain financial records for one purpose, perhaps regulatory or civil, and then to use them for another purpose -- criminal investigation or prosecution. As to the first point, there may be some less drastic means of avoiding the "data bank" problem, perhaps a requirement that the records be destroyed or returned to the originating agency if no formal criminal investigation is initiated within six months of receipt by the Department of Justice. As to the second point, we would take the view that all citizens and particularly federal employees who are sworn to support and defend the Constitution and laws of the United States, have an obligation to report federal criminal violations that come to their attention. In fact, under aggravated circumstances the withholding of information concerning criminal activity can be a federal felony, 18 U.S.C. 4, Misprison of a felony. Even in the Fourth Amendment area, the courts have recognized the "plain view" doctrine permitting the seizure of evidence in "plain view" even in the absence of a warrant specifying the item seized.

In short, we believe very strongly that 12 U.S.C. 3412 should be amended to create an exemption for criminal referrals to the Department of Justice. We are, however, more than willing to discuss revisions in our original proposal to the extent necessary to accomodate the concerns of the Subcommittee.

Question 2: The Department has had some recent setbacks regarding prosecutions in "structuring" cases. Wouldn't the Pickle bill, H.R. 4573, resolve those difficulties?

Answer:

It certainly would help and has our strong support as a supplement to the tools now available in the Bank Secrecy Act, particularly when it is accompanied by regulatory changes to 31 Code of Federal Regulations, Sections 103.11 et. seq. However,

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this remedy is insufficient to correct the problems of illegal money laundering which are addressed by H.R. 2785. Passage of the Money Laundering and Related Crimes Act of 1985 would significantly assist law enforcement efforts in several significant ways. Several examples are set forth below.

Presently, in order to convict an individual or a financial institution of a Title 31 offense, the United States must prove actual knowledge of the reporting requirements and actual knowledge that the reporting requirements governed the individual transaction(s) at issue. Actual knowledge is an onerous standard of proof, especially as applied to financial institutions. Indeed, as you review the statistics of convicted money launderers, you will notice the limited number of banks and bankers convicted of money laundering. This is, I submit, not a result of non-criminal activity, Rather, it bespeaks the difficult proof problems Assistant United States Attorneys encounter in these cases. In fact, many cases which intuitively would appear to be "criminal" must be handled civilly because of proof problems.

Under the proposed legislation, the government has the alternative prosecution standard of reckless disregard of the fact that monetary instruments or funds represent the proceeds of, or are derived from, any unlawful activity. This alternative standard of proof would greatly increase the chances of convicting both financial institutions and individual money launderers without imposing unfair burdens on innocent parties to the transactions in question. To be liable for criminal penalties under this test, it would have to be proved that the subject in question consciously disregarded an obvious risk in a manner that constituted a gross deviation from the standard of care that a reasonable person would exercise under the circumstances.

Under the Bank Secrecy Act, institutional or individual money launderers are most frequently prosecuted under 18 U.S.C. 1001 (False Statement) and/or 18 U.S.C. 371 (Conspiracy). The operative prosecution theory is that the money launderers schemed or conspired to cause a financial institution to fail to file a Currency Transaction Report (CTR). Thus, the depository acts of the money launderers are not *per se* prohibited, rather, what renders the conduct illegal is the plan employed to hide the fact of the transaction in currency (*i.e.* its source, origin, and existence) from the Department of the Treasury. This prosecution

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theory, while quite viable, is a roundabout way of attacking the problem of money laundering. Often, prosecutors are needlessly forced to immunize a witness, offer very favorable plea bargains to co-conspirators, or treat the financial institution civilly in order to break the conspiracy of silence which permeates money laundering circles. The Hobson's choice imposed upon prosecutors would be significantly diminished with passage of the proposed legislation.

The Money Laundering and Related Crimes Act would directly prohibit an individual or an institution from conducting a transaction involving the movements of money generated by or derived from the commission of any crime. Further, whereas the Bank Secrecy Act only deals with cash transactions, the proposed legislation would reach wire or other electronic transfers; transfers which are traditionally conducted by financial institutions willing to turn a blind eye to the criminal origin of the money to be transferred.

Again, the absence of this prosecutive mechanism in the Bank Secrecy Act has caused the statistics regarding convicted bankers to be artifically low.

Under 31 U.S.C. §5322 an individual who is convicted of a felony may be sentenced to up to five years in prison and/or fined $500,000, or both. Under current parole guidelines, if a money launderer is convicted of laundering less than $500,000 but greater than $100,000, his parole eligibility range, absent extenuating circumstances, will be 24 to 36 months. If a money launderer is convicted of laundering more than $500,000, his parole eligibility range, absent extenuating circumstances, will be 40 to 52 months. Thus, money laundering prosecutors can realistically expect to incarcerate money launderers who have handled millions of dollars in narcotics money for the maximum of fifty-two months regardless of the sentence actually imposed. These guidelines reflect the perception that Title 31 offenses are essentially banking regulatory crimes.

Under the proposed legislation, the maximum sentence for the crime of "money laundering" will be twenty years and/or $250,000 or double the value of the funds laundered, whichever is greater, or both. Thus, with the separate designation of a crime entitled money laundering, which has penalties attached which are substantially equivalent to narcotics statutes, it is expected that money launderers will be incarcerated for a period of time commensurate with the offense committed.

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The proposed legislation also provides for forfeiture of the proceeds of money laundering. Under existing law no forfeiture provision exists. As a consequence, a prospective money launderer, individual or institution, can anticipate minimal jail time in a Federal Correctional Institution after which the proceeds of his money laundering, safely stored in a foreign Bank Secrecy jurisdiction, will be his to use. Recognition of this penal reality has encouraged an almost cavalier attitude among money launderers. If detection is so difficult and prosecutions result in minimal jail time, why sacrifice the profits which can realistically be anticipated from a sucessful criminal enterprise. The forfeiture provision, as it dovetails with the enhanced penalties, should provide a sobering answer to this question.

While the broad language of the Financial Privacy Act would arguably allow financial institutions to provide information or access to copies of the information contained in the financial records of a customer, the realistic fear of civil suit by the customer for precipitous disclosure of such information has substantially chilled the interest of bankers in providing full disclosure of suspected law violations. The absense of this information has significantly hindered law enforcement efforts at early detection of money laundering violations and seizure of these violators and their criminal bounty.

The proposed legislation would allow financial institutions to more readily share with federal law enforcement authorities information and records which are relevant to crimes against (or by) financial institutions, violations of the Bank Secrecy Act, violation of specific drug offenses and violation of the proposed Money Laundering and Related Crimes Act of 1985. The upshot of this provision is to allow financial institutions the opportunity to provide law enforcement agencies necessary information without risking civil liability and means to do so without the obligation of notifying the customer of the cooperation. The importance of early yet confidential disclosure of financial information and records is critical to effective law enforcement. Again, the list of persons convicted of money laundering offenses would, I project, be substantially longer if this segment of the proposed legislation were presently the law.

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Question 3: The Department already has an arsenal of primary offenses utilized in Title 31 prosecutions, such as false bank entries, defrauding the U.S., RICO, Title 26 offenses, Title 21 offenses, etc. Why is it necessary to create a new criminal offense?

Answer:

We are increasingly encountering professional money laundering operations in which the offenders wash currency without regard to whether the "client" is a narcotics trafficker, traditional organized crime syndicate or a tax evader. As we are often unable to prove knowledge of the illegal source of funds on the part of the launderer, we are limited to a prosecution for failure to report currency transactions. Even then, as explained in my answer to question 2, prosecutions are limited to instances where the money is physically transported into or out of the United States or where the criminal is so indiscreet as to use a financial institution to carry out his plans. Even where we can demonstrate multiple counts, courts are inclined to sentence such offenders leniently. A substantive Title 18 money laundering offense would, in our view, be a vitally needed tool for effective prosecution of money launderers and could be expected to have a much greater deterrent effect than current law.

Question 4: Under current regulations, the CTR filing duties are placed solely upon the financial institution, not the customer. Wouldn't placing a duty also on the customer to file or to sign a sworn statement be an additional effective law enforcement tool?

Answer:

Yes, in fact, the "application for the transaction", or "transaction slip" need not be sworn so long as the institution and its regulators rely upon it in determining whether to file a CTR. It is our understanding that the Department of the Treasury is currently drafting regulations to complement H.R. 2785 and make it more difficult to "structure transactions."

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Question 5: Why do you feel Treasury needs summons authority? Specifically, what are they precluded from doing now under existing authority?

Answer:

The Department of the Treasury is in the best position to respond to this question. We support the summons authority provision in H.R. 2715, however, as it is our understanding that Treasury presently lacks such authority in connection with investigations in preparation for imposition of administrative penalties. Thus, in cases where we determine that we cannot proceed with a criminal prosecution, Treasury is seriously disadvantaged in terms of imposing administrative penalties. As the administrative penalty is a valuable adjunct to criminal prosecution, we believe the summons provision is highly important.

Question 6: It is my understanding that the offense of money laundering created in the Administration's bill is not limited to cash transactions through financial institutions, but would cover any transaction involving the movement of funds that affects interstate commerce, whether or not it involves a financial institution, and which is conducted with the intent to facilitate any unlawful activity or with the knowledge or reckless disregard of the fact that the funds were derived from illegal activity.

(a) What is meant by "any unlawful activity"?

(b) Is the standard "reckless disregard" an appropriate standard for criminal liability -- especially for this offense?

(c) Does this extremely expansive definition give you pause to consider what ultimate effect such a sweeping criminal statute could have on protected constitutional rights and what effect such a statute would have on the rights of individual states to administer their criminal laws?

Answer:

At the outset, we should note that we are keenly aware of concerns with respect to the breadth of our proposed substantive criminal money laundering offense. While we continue to support the formulation embodied in H.R. 2785, we would not object to adjustments necessary to resolve some of the concerns which have arisen.

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As to your specific questions, "unlawful activity" is defined at Sec. 2(c)(5) as any federal or state felony.

We believe "reckless disregard" is an appropriate standard for criminal liability. The most recent precedent for such a standard is the product tampering statute, 18 U.S.C. 1356, enacted in 1983. As defined at Sec. 2(c)(6), we believe the "reckless disregard" standard is eminently defensible. Moreover, given the fact that money launderers often make it a point "not to know" the source of the currency they are laundering, such a standard is greatly needed to convict sophisticated operators.

Finally, we are confident that the administration of this provision would not adversely affect individual rights. As to state law enforcement, our general policy in matters of concurrent federal-state criminal jurisdiction is to defer to state prosecution in the absence a compelling federal interest in the matter. We believe this legislation complements existing state laws in those situations where the felon or his professional money launderer purposefully transmits the proceeds of the crime (usually a pattern of crimes as in narcotics trafficking) outside the territory of the state. In those instances, the Article III counts with national subpoena power and national investigative agencies are needed to recover the ill gotten proceeds and punish the wrong doers who profit from being in the chain of persons and entities spiriting the proceeds away.

Question 7: As you know, the Right to Financial Privacy Act of 1978 (RFPA) was passed, in large part, as a result of the Supreme Court's decision in United States v. Miller. The Court held that citizens had no property or privacy interest in their bank records. The Act, in effect, overturned that decision.

At present, there is a move to substantially amend RFPA because it is claimed by some that current law has created clear impediments to criminal law enforcement efforts. Has RFPA Created clear impediments to criminal law enforcement efforts and, if so, please explain.

Answer:

We believe the RFPA has impeded law enforcement, particularly in the areas where we have sought amendments. Most importantly (1) it deters financial institutions and other federal agencies from reporting bank related crimes to the Department of Justice; and (2) by applying only to federal agencies, it creates questions in some areas as to whether the RFPA or similar but inconsistent state laws apply to federal investigative access to financial records.

Question 8: In testimony before the Subcommitteee, Mr. Richard Wassenaar, Assistant Commissioner, Criminal Investigation, IRS, testified that during 1985 the IRS recommended prosecution of 137 cases involving money laundering. How many of these recommendations were pursued by the Department of Justice? What is the current status of these cases?

Answer:

According to figures provided by the Internal Revenue Service, Fiscal Year 1985 (FY85) began with 144 allegations of possible Title 31 violations under review by the U.S. Attorneys or pending indictment. During FY85, the IRS referred an additional 317 matters to the U.S. Attorneys. Of those 451 matters, it is our understanding that 276 were indicted, prosecution was declined as to 25 matters and 150 were under review or pending indictment at the end of the fiscal year. During FY85, there were 163 convictions for Title 31 violations which had been investigated by the IRS. However, because of the time which passes between indictment and trial, not all of those 163 convictions were for matters referred or indicted during FY85.

Question 9: The Banking Committee received a letter from Mr. Frederick B. Lacey, Chairman, Advisory Committee on the Federal Rules of Criminal Procedure of the Judicial Conference of the United States, a copy of which is attached. Mr. Lacey states that "with regard to grand jury subpoenas for financial records, the Right to Financial Privacy Act of 1978 . . . has created doubt concerning the courts' power." He cites two provisions of RFPA, one which permits a delay in notifying the customer that a subpoena has been served on a financial institution, and the other provision which exempts grand jury subpoenas and related court orders from the Act. Do you share Mr. Lacey's concern?

Answer:

Yes. Prosecutors report that this is one of the most difficult problems they face.

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TAX EVASION, DRUG TRAFFICKING, AND MONEY LAUNDERING AS THEY INVOLVE FINANCIAL INSTITUTIONS

WEDNESDAY, MAY 14, 1986

House of Representatives,
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance,
Committee on Banking, Finance and Urban Affairs,
Washington, DC.

The subcommittee met, pursuant to call, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of the subcommittee) presiding.

Present: Chairman St Germain, Representatives Barnard, Manton, Wylie, McCollum, and Wortley.

Also present: Representative Esteban E. Torres of the full committee.

Chairman St Germain. The subcommittee will come to order.

Today, the subcommittee continues its hearings, the fourth in this series which the subcommittee has held to determine how best Congress can respond to the abuse of financial institutions by criminal elements in our society to further their illegal gains, especially as they relate to tax evasion, drug trafficking, and money laundering.

Previously, the subcommittee has heard extensive testimony from the Departments of Treasury and Justice representing the views of the administration on its and other legislative proposals that have been referred to the subcommittee. We have heard from the banking regulators on these matters as well. In addition, the subcommittee heard from a former money launderer, who vividly demonstrated how easy it was to abuse this Nation's financial system for illegal gain.

Our first witness today is the Honorable Martha R. Seger, member, Board of Governors of the Federal Reserve System. The subcommittee is interested in knowing, among other things, what influence the Federal Reserve can bring to bear on other central banks to cooperate with international law enforcement authorities in efforts to combat illegal activities—particularly those which are the subject of these hearings.

The Chair would note that this is Governor Seger's first appearance before the subcommittee and we extend a most cordial welcome to her.

Following Governor Seger, the subcommittee will hear from a distinguished panel composed of Messrs. James D. Harmon, Jr., former Executive Director, President's Commission on Organized Crime; Samuel J. Buffone, member, White Collar Crime Committee, American Bar Association, Earl B. Hadlow, representative, American Bankers Association; and Lawrence B. Pedowitz, representative, Committee on Federal Legislation, the Association of the Bar of the City of New York.

The Chair wishes to announce that Mr. Jerry Berman, chief legislative counsel, American Civil Liberties Union, was scheduled to appear with the panel today. Unfortunately, because of other pressing matters, Mr. Berman is unable to be with us. Without objection, Mr. Berman's letter of explanation for his absence together with his prepared written statement will be submitted for the record with the prepared statements of the other panelists.

Governor Seger, again, welcome to the subcommittee. Your entire statement, without objection, will be placed in the record.

At this time, I recognize our ranking minority member, the Honorable Chalmers Wylie.

Mr. WYLIE. Thank you very much, Mr. Chairman.

First I would like to welcome our witnesses today and I am particularly pleased that Governor Seger is able to make her first appearance before this subcommittee to present the Federal Reserve Board's comments on the Bank Secrecy Act and related measures.

But, second in view of the primary interest of our second panel, I would like to say just a few words about the Right to Financial Privacy Act. The purpose of the Right to Privacy Act is to protect the customers of financial institutions from unwarranted Federal Government intrusion into their records without interfering simultaneously with legitimate and necessary law enforcement activities of the Federal Government. While the concept of privacy may seem relatively simple, it is at the same time a very emotional issue to many and as examination of the act indicates in applying this concept in legal terms it is highly complex.

The privacy of customers of financial institutions is certainly protected to a greater extent as a result of the Right to Financial Privacy Act. Obviously a range of controversial and complex questions of political, social, ideological, and legal nature are also raised in deciding the extent to which a person's financial records should remain protected from Government intrusion.

The difficult problem is striking a balance which assures reasonable privacy protection to individuals while not impairing the Federal Government in its vital role of law enforcement investigation. I look forward to your testimony, Governor Seger, and I thank you very much, Mr. Chairman, for allowing this opportunity for an opening statement.

Chairman ST GERMAIN. Mr. Barnard.

Mr. BARNARD. Mr. Chairman, thank you very much. I have no opening statement but I thought it was very significant this morning that we have been chosen by a number of foreign exchange students who are visiting in our country to witness the hearings this morning, and we are delighted to have you here.

We welcome you to this hearing, and I think it is a good example of how the House of Representatives of the U.S. Congress works and we hope that this will be a very meaningful and exciting experience for you.

Normally there is more storm and lightning in these hearings, but I am sure this will be sufficient to give you an example of how Congress works.

So I want to, just on behalf of the chairman and the other members of the committee, welcome you to the hearing this morning.

Chairman ST GERMAIN. I thank the gentleman.

I just want to add my welcome. Frankly, it is very opportune that you are here because our first witness, the Honorable Martha Seger, who is on the Federal Reserve Board which is our central bank, is going to tell us about the dealings that our central bank has with other central banks. We have found that in some instances there is reason to believe that some central banks cooperate with money laundering, with the illegal transfer of funds and so perhaps—I don't know which countries you are from, but it may be an incentive for you to watch what your central banks are doing as far as money laundering is concerned.

At this time, Governor Seger, we have placed your entire statement in the record. You may proceed.

STATEMENT OF HON. MARTHA R. SEGER, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Governor SEGER. Thank you very much, Mr. Chairman. I appreciate the opportunity to appear before the subcommittee today on behalf of the Federal Reserve Board and I will begin by focusing on the Bank Secrecy Act and on the various legislative proposals to strengthen this act.

As the subcommittee is aware, the widespread publicity surrounding Bank Secrecy Act reporting failures has heightened awareness of financial institutions, their regulators, and the public at large, as to the importance of better compliance.

As a result of renewed attention to the act, many banks have conducted in-house compliance audits and have since made special efforts to tighten internal controls. At the outset, I should point out that these efforts appear to be working as the volume of currency transaction reports [CTR's] filings has increased dramatically. In part because of this volume increase I believe that is is time to consider streamlining and modernizing the reporting process, especially for large institutions that must submit a high volume of CTR's to the IRS. This could include, for example, the use of computer-generated tapes and other technology to minimize the avalanche of paper. An additional benefit of such approach could be an even better reporting procedure.

Regarding compliance, I should stress that Federal agencies have made a concerted effort to improve their enforcement capability. The Fed, for example, has instructed its examiners to implement in-depth assessment procedures for Bank Secrecy Act compliance during all full scope examinations. We have also expanded coverage of the Bank Secrecy Act in our training program for bank examiners, and have been an active participant in an interagency working group designed, among other things, to improve coordination of Bank Secrecy Act compliance activity.

Despite improved compliance with the act, we know that better recordkeeping alone will not put an end to money laundering in this country. Those engaged in money laundering are a resourceful lot and have incentives to circumvent even the most carefully crafted rules and regulations.

Yet efforts to contain money laundering by making it more difficult and risky are in the public interest and should continue.

At present, the burden of the Bank Secrecy Act clearly falls more on depository institutions than on those directly involved in money laundering. In the Board's view, it is more appropriate to strengthen enforcement through better utilization of current resources and to strengthen prosecution by making money laundering a crime rather than to increase reporting burdens.

While we generally support the objectives of the bills before the subcommittee, it is important that their provisions be closely evaluated to ensure that they contribute to law enforcement efforts without unduly adding to financial institutions' reporting burden.

While my written statement details more thoroughly our view of certain proposals before the subcommittee, let me just highlight several issues.

First, four of the bills before the subcommittee, namely H.R. 2785, H.R. 1367, H.R. 1474, and H.R. 1945, would make money laundering a Federal crime, a change the Board supports.

Two proposed bills, H.R. 4573 and H.R. 3892, are aimed at giving enforcement authorities additional tools to prevent one common means of evading the act, namely structuring transactions involving more than $10,000 into multiple transactions of a lesser amount. The Board supports efforts to limit such structuring.

H.R. 1474 contains a provision that would require Federal supervisory agencies to verify compliance with the Bank Secrecy Act in the course of every examination they perform. In order to make more cost-effective use of our resources, we would like to retain the flexibility to determine the parameters and frequency of such visits and thus suggest that the provision not be adopted by the subcommittee.

H.R. 1474 would also provide that every exemption to the Bank Secrecy Act's requirements be approved by the Treasury and H.R. 3892 would require an annual review by Treasury of all exemptions.

We agree with the testimony by Treasury before this subcommittee that it is not desirable to shift this determination to Treasury and away from the financial institutions that, after all, are in a better position to know the identity of the transactional habits of their own customers.

H.R. 1474 would require that all outgoing international wire and other electronic transfers be reported on a currency or monetary instrument report. While we generally believe that wire and other electronic transfers should be included among the types of transactions regulated by the act, we believe that such information is more effectively acquired through Treasury's existing authority to require specific financial institutions to provide copies to Treasury of all wire transfers taking place within a particular period of time.

Regarding proposals in H.R. 4280 to codify the size of transactions subject to Bank Secrecy Act reporting, we believe that Treasury should retain its regulatory flexibility and thus maintain its ability to respond to changing criminal practices.

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Finally, H.R. 3892 contains a provision that would include any foreign subsidiary or affiliate of a U.S. commercial bank in the definition of financial institutions for purposes of the Bank Secrecy Act. H.R. 3892 would, for the first time, give extraterritorial effect to the reporting requirements, placing U.S. banks in some instances in conflict with local law and raising important areas of friction with many host countries who have been particularly sensitive to the extraterritorial application of U.S. law.

You asked that we revisit certain titles of the Financial Institutions Regulatory and Interest Rate Control Act to determine whether they could be strengthened. Let me begin with title I of this act, which is designed to provide the bank regulatory agencies with enhanced tools for combating violations of banking law and unsafe and unsound activities.

Title I authorizes, among other things, the use of civil money penalties for violations of various banking laws and provides for enforcement authority against individuals as opposed to institutions.

Important though these powers are, we should bear in mind that the Federal Reserve Board is not a criminal law enforcement agency. While our examiners are trained in detecting questionable transactions, any suspected criminal activities are referred to appropriate law enforcement authorities.

The Federal Reserve has been working diligently to improve the criminal referral process. In August 1985, the Fed distributed to the financial institutions it supervises a uniform criminal referral form. Moreover, the Federal Reserve recently developed procedures to ensure that criminal referrals involving activities that may affect the safety and soundness of a bank or bank holding company are submitted directly to the fraud section of the Department of Justice for high level attention.

In addition, procedures have been established to ensure that criminal forms submitted to the Fed are properly handled and computer systems have been developed to track and cross-check the referrals against the activities of the enforcement section of the Board's Division of Banking Supervision and Regulation.

Title VI of the Bank Act of 1978 gives bank regulatory agencies authority to act on notices involving changes in the control of insured banks and bank holding companies. Typically, supervisory authorities are familiar with individuals who are seeking to gain control of a financial institution. However, there are sometimes cases such as those involving foreign individuals or individuals who previously have not been involved in banking which require the reviewing agency to draw on information from law enforcement agencies and foreign banking agencies.

Because of the time involved in this process, we would favor an amendment to the change in Bank Control Act that would allow the Board to extend the processing period in those rare situations when it is necessary to collect and evaluate additional information about potential criminal activity.

Title XI of the Right to Financial Privacy Act was intended to protect bank customers' privacy rights while enabling Federal regulatory and law enforcement agencies to carry out their responsibilities under the law.

The Right to Financial Privacy Act, however, does not preclude any financial institution from notifying Government authorities that it has information which may be relevant to a possible violation of any statute or regulation.

The uniform interagency criminal referral form was developed for the use of financial institutions in making such notification. The form has been carefully structured to elicit information that we were not getting before, perhaps as a result of perceived Right to Financial Privacy Act problems.

Out of the approximately 400 referrals made by the institutions since the form was developed, only 3 have lacked necessary information due to perceived Right to Financial Privacy Act problems, and these instances did not involve Bank Secrecy Act violations.

We believe that adoption of these forms by all supervisory agencies will address through administrative action many of the difficulties experienced by the law enforcement agencies in this area.

Now I would like to turn to international cooperation. In general, the Fed maintains extensive contact with foreign bank supervisory authorities in order to discuss broad supervisory issues. The most visible example of such contact is the Basle Committee on Banking Regulations and Supervisory Practices. The Fed also sends a representative to regional meetings of supervisors from the Caribbean, Latin America, and Asia.

The Fed stands ready to assist the Justice Department by making quick referrals of suspected criminal activity to the appropriate authorities and by providing advice on international transactions. In our view, steps to enhance international enforcement efforts are best handled through initiatives such as those undertaken by the Department of Justice to institute mutual legal assistance treaties between the United States and other countries.

At the same time, the Federal Reserve will continue efforts to heighten the sensitivity of banking authorities abroad to the problems of money laundering through the international banking system.

In June 1985, this subject was raised informally by the Federal Reserve's representative to the Basle supervisory committee. Another occasion for such discussions will be the forthcoming meeting of the committee to be held in Washington at the end of next month. It is important to point out, however, that the ability of bank supervisors to deal with activities such as drug trafficking and money laundering is limited. It is, for example, difficult to monitor international financial transactions given the number and volume of such transactions each day.

Moreover, even if such monitoring were feasible, it would be problemmatic at best to hope to draw valid conclusions regarding ultimate origins or destinations of individual transactions.

Further, both foreign and domestic bank supervisors usually are not empowered to investigate criminal activity and therefore must refer any evidence of illegal conduct to their respective law enforcement authorities. Foreign bank supervisors may also face serious legal obstacles when disclosure of information on individual customers is involved. It is with regard to these obstacles that mutual assistance treaties are particularly useful.

In conclusion, I would like to emphasize that the Federal Reserve, in conjunction with other Federal agencies, has intensified its efforts to address the problem of criminal activity involving financial institutions.

We understand the critical importance of promoting improved enforcement and prosecution of bank-related criminal activity, and we look forward to working with this subcommittee as it reviews and weighs the merits of the various proposals before it.

Thank you very much.

[The prepared statement of Governor Seger can be found in the appendix.]

Chairman **St Germain**. I would like to make an observation on the change of control. I certainly agree with you and with your position that there are times when you should have more than that 30-day extension beyond the 60 because I have observed instances—and I think we have written to the regulatory authorities to express our dismay at certain approvals because we ourselves had information to the effect that there was an element creeping into a particular area to take control of a financial institution that certainly had an unsavory element.

I am sure that there are those who will scream and yell and say, "Well, this is just an opportunity to further hinder and delay, and there is a lot of cost involved." But I want you to know that as far as this member is concerned, I am very sympathetic to your request and I doubt that the regulatory agencies would abuse it.

As a matter of fact, if anything, I think they acted too quickly in some instances and didn't take the time that they should have taken. If there is a cost involved to those who are seeking this change of control; well, that is the way the cookie crumbles.

So I reiterate that I certainly am very sympathetic to that request.

As to the international cooperation aspect, I think it is important. For instance, the testimony we received on Hong Kong and Panama, particularly Panama emphasizes this. You have to have a very low IQ not to realize that there is money laundering going on through Panama and that they are the prime violator.

I realize we cannot expect the regulatory authorities and the Fed to be able to do it all. By the same token, I think that continued emphasis and monitoring is very important. As you will recall, in the first case that achieved prominence last year, much of the information we received was helpful, particularly the information from the Federal Reserve Bank in Boston where they noted the tremendous and dramatic increase in the requirement for cash or the cash being processed.

So I think the Fed really and truly can play a very important role, due to the structure and the processing that goes through the Fed. Am I correct in my assumption that we have also seen a rather substantial increase similar to that which appeared at the Boston Fed in California?

Governor **Seger**. I don't know that it would be the same percentage, but there definitely has been an increase.

Chairman **St Germain**. Because we have had testimony that a lot of the operations have gone to California. There are still a lot in Florida, but there has been a rather dramatic increase in California as well. However, we don't want to forget the fact that Hong Kong is processing a lot of cash as well.

Mr. Barnard.

Mr. **Barnard**. Thank you, Mr. Chairman.

Governor you talked in your testimony about the Right to Financial Privacy Act. This may be a little bit apart from our subject today, but aren't there a lot of insider criminal activity in banks somewhat being protected by the Right to Financial Privacy Act? There was a legislation proposed which has never moved which would exclude the Right to Financial Privacy Act of insiders like bank presidents, chairmen of the board and directors when there was criminal misconduct, but the Right to Financial Privacy Act has been protecting some of those from the standpoint of their prosecution.

Has the Fed looked into that at all?

Governor **Seger**. Do you mind if I call on someone else for this, as I have not dealt with it?

Mr. **Barnard**. You haven't had the problem as much as the comptroller at the Federal Home Loan Bank Board and the FDIC and FSLIC, but in a number of cases—I won't name the banks because I don't think I need to—but the prosecution of those who are wrongdoing within the bank has been handicapped because of the inability to get to the financial records.

I guess the question is, would the Fed support legislation which exempted the right to privacy of those insiders who are trying to hide behind it?

Chairman **St Germain**. Excuse me, did you say you had someone with you that you would like to have address this?

Governor **Seger**. I think a member of the staff can give you more information than I.

Chairman **St Germain**. One of those brilliant behind the scenes——

Governor **Seger**. Right behind me.

Chairman **St Germain**. They are all looking at each other to see who will answer it.

Governor **Seger**. I will keep them guessing for a minute. I am aware of major problems with insider transactions but I don't know to what extent the Right to Financial Privacy Act has made it tough to get at them.

Mr. **Barnard**. I apologize for going far afield, Mr. Chairman, but this is important.

Chairman **St Germain**. This is not far afield, I say to the gentlemen, because it should certainly be part of the legislation. It is within our jurisdiction and it is very important.

Governor **Seger**. I will ask Mr. Herb Biern with the enforcement section of our Supervision and Regulation Division, who does all of our work in this area. I think he would be able to fill in where I cannot.

Mr. **Biern**. Congressman, I serve as representative of the Board on the Interagency Justice Department Task Force. When we first started meeting a year ago September, one of the major issues we were looking at was the effect of the Right to Financial Privacy Act in criminal processes and the perception that there was a great deal of limitation placed by this act on criminal processes.

First we monitored the problem and second, we started drafting the criminal referral form to elicit the information that perhaps was not being given to us because of perceived problems with the Right to Financial Privacy Act.

Our experience since that form has been in place since August 1985, as Governor Seger said, has been very positive with respect to the effect of the Right to Financial Privacy Act. Only three referrals have not had information in them because of statements by the financial institution that they couldn't give us the information. I think that indicates that on a concrete data basis it is not as much of a problem as we thought.

Working on specific cases with the Justice Department the Right to Financial Privacy Act in the first instance may limit the ability to get information, but all you need is a grand jury subpoena or notice of the customer. The banking agencies have been working very closely with the Justice Department cooperating with the grand jury process to get those subpoenas out and working with the assistant U.S. attorneys and FBI to get the initial information needed to get a grand jury working.

So on behalf of the Federal Reserve we have not had any specific case of limitations in prosecution because of the Right to Financial Privacy Act.

Mr. **Barnard**. But the record will indelibly show that in certain major instances we have had no processes of insider criminal, a Penn Square Bank, and so if it is a handicap, you know, while we are considering reforms at this particular time, Mr. Chairman, it would be well for us to look at that.

Chairman **St Germain**. What is the gentleman telling us, and we can be specific because Penn Square is not a secret to the world?

Mr. **Barnard**. Right, and United American Banks in Tennessee.

Chairman **St Germain**. But are you stating that you have information from your subcommittee hearings to the effect that they didn't go the criminal route?

Mr. **Barnard**. Insiders violating the law can stand behind the Right to Financial Privacy Act because they have so-called quote customers of the act.

Chairman **St Germain**. That is a valuable consideration and one that I think we would appreciate, if we could have those portions of the testimony from your subcommittee brought to our attention.

It would help us in our deliberations.

Mr. **Barnard**. Thank you very much.

Governor, have we gone from what could be called the sublime to the ridiculous. We have gone from no reporting to such voluminous reporting that IRS cannot keep up with it. Isn't that true?

Governor **Seger**. I have some feeling that might be the case, particularly when I see the forms that are used and one of these pieces of paper for every transaction exceeding $10,000, they must be——

Mr. **Barnard**. 500,000 I understand is the latest total that they are sitting on. It is going to be impossible to process that number. Wouldn't you think?

Governor **Seger**. I would think so. One of my suggestions as I was preparing for this testimony was that the IRS could consider allowing institutions to submit the same information but do it in the form of magnetic tapes that would come off one computer and fit on the IRS computers. Doing so would allow them to process it more rapidly.

Mr. BARNARD. Do the agencies by any chance tabulate the number coming from, say, one particular bank and it would alert them to make them a little more conscientious in examining that particular institution?

Governor SEGER. They go directly to the IRS.

Mr. BARNARD. OK, IRS doesn't do that.

Governor SEGER. They don't pass through our hands.

Mr. BARNARD. My time has expired, Mr. Chairman.

Chairman ST GERMAIN. I would say that to the best of my knowledge as far as that part is concerned, there is an experiment going on now on that very point, and that the bulk of this, under the present legislation, permits the IRS and Treasury regulatory authorities to make changes. So remember, the $10,000 threshold was set by Treasury, and they have the authority to increase it, decrease it, or whatever.

Mr. Wylie.

Mr. WYLIE. Thank you, Mr. Chairman.

Governor Seger, on pages 8 and 9 of your statement, you object to requiring any foreign subsidiary or affiliate of a U.S. bank to file a currency transaction report for cash and currency transactions of $10,000 or more.

You argue that such a requirement may place these foreign subsidiaries in conflict with the host countries. Could you give me any examples of how this might happen or what might be the consequences or where it might occur?

Just an explanation in other words.

Governor SEGER. I think one of the examples I could provide you is perhaps a Swiss case whereby an American bank would have a branch in Geneva, Switzerland. If we imposed this reporting requirement on that branch of an American bank then they would have a competitive disadvantage because they are competing in the marketplace with banks and branches of other banks that operate in a different supervisory and regulatory environment, and as we all know Switzerland takes a very different approach to this whole business of revelation of information.

Mr. WYLIE. I know, we had some hearings in Switzerland and as a matter of fact, the chairman was over there and we met with the entire board of directors of the Central Bank of Switzerland. During the course of the proceedings I asked them how you go about getting a secret Swiss bank account and they said——

Governor SEGER. That was a secret. [Laughter.]

Mr. WYLIE. He said I will talk to you about it after the hearing if you would like to have one. I decided I didn't need it but they are very secretive. But they have been somewhat forthcoming according to information we heard in the First Boston case. I think some of the information we got about some possible money laundering came from them.

But your specific reason is that there would be a competitive disadvantage with banks in those foreign countries?

Governor SEGER. Yes.

Mr. WYLIE. Vis-a-vis our own banks?

Governor SEGER. Well, it could also be that a Swiss citizen could be coming into that branch of an American bank and depositing Swiss francs or other kinds of foreign currency that would also have to be picked up under the reporting requirement.

I think the legal issue is can we apply our laws, rules, regulations, extraterritorially?

Mr. WYLIE. We certainly couldn't apply it to the Government of Switzerland but we could apply it to our own banks, couldn't we?

Governor SEGER. Well——

Mr. WYLIE. Even though it would be a foreign subsidiary affiliate? That is a legal question I suppose and I probably ought to ask it at another time and place. On page 2 you note that most of the recent well-publicized violations of the Bank Secrecy Act were not due to criminal intent but rather to the failure of the bank to have adequate controls or procedures.

Do you feel banks have adequate controls and procedures now in effect? What about the Edge corporations? That would apply in the case of the Swiss analogy which you made there. Are they subject to the same degree of scrutiny as member banks?

Governor SEGER. Most of the Edge Act subsidiaries do not handle cash but those that do have a cash operation would be subjected to the same examination procedures as, say, an ordinary member bank or branch of a member bank.

On the overall question of how we are doing in examining for BSA compliance, I think that we definitely have given some emphasis to it. We are using the same basic procedures but we have expanded our examination. It used to be that we would start by a cursory view, and then if there was reason to suspect compliance problems the examiner would go into a more thorough mode. Now the examiners are automatically looking into Bank Secrecy Act compliance in the thorough way.

Mr. WYLIE. I think Chairman Volcker indicated that the various Federal agencies have recently agreed on the Uniform Bank Secrecy Act examination procedure. Has that been implemented?

Governor SEGER. Well, the Fed has had, I am told, a bank examination procedure for this for years, and the basic procedure is not changed. Now some other agencies are adopting our approach so that we are getting at uniformity that way.

Mr. WYLIE. Thank you very much.

Chairman ST GERMAIN. Governor Seger, I am sorry, I cannot bite my tongue any longer. In essence let's use the example of a branch of a U.S. bank in Switzerland. In reality, what you said was that they would be at a competitive disadvantage, that they couldn't launder as much money as the Swiss banks could if we require this reporting, correct? If this is what you meant; I am not too sympathetic to that argument.

Governor SEGER. I think maybe we are making different assumptions.

My assumption is that not everybody who comes in with a significant currency deposit or goes for a significant currency withdrawal would be, "engaging in money laundering."

Chairman ST GERMAIN. That is true, but you cannot assume that none of them are engaged in money laundering, right? That is why we have the reporting requirements for cash transactions because there are indeed a lot of people laundering money. A lot of them don't. We have exemptions for those who don't. I feel it should be left to the banks to determine this and that that burden should not be placed on Treasury.

I agree with you on that.

Governor Seger. My legal adviser has just informed me that it is illegal under Swiss law to disclose this information subject to criminal penalty.

Chairman St Germain. You know that doesn't influence me one bit, because for years on this subcommittee and full committee we have been trying to deal with this preposterous Swiss law of secrecy. As far as I am concerned, that is balderdash. When we were over there I said to Paul Volcker in our meeting in Bern, when he was talking about reciprocity, "Well, you know the trouble is when you talk about reciprocity"—they want a lot from us, Governor Seger, so we have a little to work with—my reply was that the trouble I have with reciprocity is that I don't know which dictionary you use to define it.

So I don't have any sympathy whatsoever for the fact that the Swiss law says you cannot do that.

Mr. Manton.

Mr. Manton. Governor Seger, the sense that I get from your testimony is that there are in your opinion enough regulations and laws on the books as to reporting and recordkeeping. You are suggesting that we go a step or two further in adopting some substantive Federal laws with regard to making money laundering per se a Federal crime.

Is my understanding correct?

Governor Seger. Yes; it is, sir.

Mr. Manton. And you feel that increased recordkeeping requirements would not have an impact on our efforts to fight money laundering?

Governor Seger. That is the Fed's present view.

Mr. Manton. In other words, we should adopt measures that define money laundering as a Federal crime?

Governor Seger. Yes, sir.

Mr. Manton. Perhaps not put an emphasis on bookkeeping, et cetera?

Governor Seger. Not beyond what is now required. Right.

Mr. Manton. Thank you.

Chairman St Germain. Mr. McCollum.

Mr. McCollum. Thank you, Mr. Chairman.

Governor Seger, would you be willing to provide to us copies of the criminal referral form that you say you now have? I have never seen it. I am glad to know you have it.

Governor Seger. I didn't see it myself until I prepared for this hearing but yes, we will give you that.

[In response to the request of Congressman McCollum, the following information was submitted for the record by Governor Seger:]

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MARTHA R. SEGER
MEMBER OF THE BOARD

May 19, 1986

The Honorable Bill McCollum
House of Representatives
Washington, D.C. 20515

Dear Mr. McCollum:

During my appearance before the Financial Institutions Subcommittee on May 14, you requested a copy of the Criminal Referral Form (Form FR 2230) developed by the Justice Department-Supervisory Agencies Working Group.

In addition to the form itself, I am forwarding copies of the April 1985 agreement of the Working Group and the Board's correspondence with the Federal Reserve Banks concerning use of the Criminal Referral Form.

I hope you find this information to be of assistance.

Sincerely,

Martha R. Seger

Enclosures

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Control No. (Agency use only)

FR 2230
Page 1 of 7
OMB No 7100-0212

Criminal Referral Form

Attention: This form should be filed by the reporting financial institution not later than seven business days following the discovery of the suspected violation. Additional information not readily available at the time of filing should be submitted on an amended form.

One Copy of the completed form should be filed with each of the following: (1) the local U.S. Attorney, (2) the local FBI office, and (3) the Federal Reserve Bank in the District where the financial institution is located.

Complete all items on this form where suspected criminal activity involves actual or probable loss (before reimbursement or recovery) of $10,000 or greater and in all cases, regardless of the amount, involving an executive officer, director or principal shareholder of the institution within the meaning of Regulation O of the Board of Governors.

Complete only pages one and two if suspected criminal activity involves actual or probable loss of less than $10,000 (before any recovery or reimbursement) not involving an executive officer, director, or principal shareholder of the institution within the meaning of Regulation O of the Board of Governors.

The Board of Governors of the Federal Reserve System considers this report confidential pursuant to applicable provisions of the Privacy Act, 5 U.S.C. §552a, and the Freedom of Information Act, 5 U.S.C. §552. Accordingly, the report and the information that it contains may be shared with appropriate law enforcement agencies consistent with applicable laws and regulations. In addition, persons identified in the report may in some circumstances be entitled to access to the report under provisions of the Privacy Act.

See Detailed Instructions on Page 7

1. **Name, Location and Number of Reporting Financial Institution**

Name ______

Location ______ (Street) ______ (City) ______ (State) ______ (ZIP Code)

SMB/BHC No. (if available) ______ If activity occurred at branch office(s), please identify ______

2. **Asset Size of Reporting Financial Institution** (millions of dollars) $ ______

3. **Approximate date and dollar amount (before any allowance for restitution or recovery) of suspected violation**

Date ______ (Month Day Year) Amount (thousands of dollars) $ ______

4. a. **Summary Characterization of the Suspected Violation.** Check appropriate box(es)

☐ Defalcation/Embezzlement ☐ Bribery/Gratuity ☐ Other (describe) ______

☐ False Statement ☐ Misuse of Position or Self Dealing

☐ Check Kiting ☐ Mysterious Disappearance

b. Application Section(s) of U.S. Code (if known). (See list on page 6.) ______

5. **This matter is being referred to the FBI in** ______ (City) ______ (State)

and the U.S. Attorney in ______ (City) ______ (State) ______ (Judicial District (if known))

6. **Person(s) Suspected of Criminal Violation** (if more than one, use continuation sheet)

a. Name ______ (First) ______ (MI) ______ (Last)

Address ______ (Street) ______ (City) ______ (State) ______ (ZIP Code)

Date of Birth ______ (Month Day Year) Social Security No. (if known) ______

____
Name of Financial Institution

b. Relationship to the financial institution (check all applicable blocks)

☐ Officer	☐ Employee	☐ Broker	☐ Shareholder
☐ Director	☐ Agent	☐ Borrower	☐ Other (specify) ______________

c. Is person still affiliated with the financial institution ☐ Yes ☐ No

If no, ☐ terminate* ☐ resigned Date ______________ (Month Day Year)

Describe Circumstances of Separation (if necessary, use continuation sheet) ______________

d. Prior or related referrals ☐ Yes ☐ No If yes, please identify briefly by name and date.

e. Is person affiliated with any other financial institution ☐ Yes ☐ No
or business enterprise ☐ Yes ☐ No If yes to either or both, please identify.

7. **Explanation/Description of Suspected Violation.** (Give a brief summary of the suspected violation, explaining what is unusual or irregular about the transaction.) (if necessary, use continuation sheet)

8. **Has there been a confession?** ☐ Yes ☐ No If so, by whom? ______________

9. **Offer of Assistance.** The individuals listed below are/will be authorized to discuss this referral with FBI and Department of Justice officials and to assist in locating or explaining any documents pertinent to this referral, provided that contact is first made with

Name ______________ Position ______________
Telephone ______________

Name ______________ Telephone ______________
Name ______________ Telephone ______________
Name ______________ Telephone ______________

10. **Form Prepared by** ______________
Position ______________
Agency/Institution ______________
Telephone ______________ Date ______________

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Name of Financial Institution

Complete the remaining questions if suspected criminal activity involves probable loss (before reimbursement or recovery) of $10,000 or greater and in all cases, regardless of amount, involving an executive officer, director, principal shareholder of the institution within the meaning of Regulation O of the Board of Governors.

11. **Give a Chronological and Complete Account of the Suspected Violation.** (If necessary, use continuation sheet)
    - Relate key events to documents and attach copies of those documents.
    - Explain who benefitted, financially or otherwise, from the transaction, how much, and how.
    - Furnish any explanation of the transaction provided by the suspect and indicate to whom and when it was given.
    - Furnish any explanation of the transaction provided by any other person.
    - Indicate where the suspected violation took place (e.g., main office, branch, other).
    - Recommend any further investigation that might assist law enforcement in fully examining the potential violation.

12. **Indicate Whether the Suspected Violation Appears to Be an Isolated Incident or Whether It Relates to Other Transactions.** (Explain)

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Name of Financial Institution

13. **Exclusion of Information from the Referral.** Has any pertinent information been excluded from this referral as a result of any legal or other restraint? ☐ Yes ☐ No

If so, why?

Have the excluded information or documents been segregated for later retrieval? ☐ Yes ☐ No

14. **Witnesses.** List any witness who might have information about the suspected violation and describe their position or employment. Indicate if they have been interviewed. (if necessary, use continuation sheet)

	Name	*Position*	*Address*	*Telephone*	*Interviewed*	
					Yes	No
1.					☐	☐
2.					☐	☐
3.					☐	☐
4.					☐	☐
5.					☐	☐

15. **Discovery and Reporting**

a. Who discovered the suspected violation and when?

b. Has the suspected violation been reported to the Board of Directors? ☐ Yes ☐ No By whom and when?

c. Has the Board of Directors taken action? ☐ Yes ☐ No If so, what and when?

d. Has the suspected violation previously been reported to federal or local law enforcement or to any federal or state supervisory agency? ☐ Yes ☐ No If so, by whom, to whom, and when?

16. **Loss**

a. Amount of loss known $
b. Restitution by
In the amount of $
c. Name of Applicable Surety Bond Company
d. Amount of Bond $
e. Amount of deductible $
f. Was claim filed? ☐ Yes ☐ No
g. Settlement by Surety company to date $
h. Total restitution and settlement to date $
i. Net loss (after subtracting any amounts paid in the form of restitution or settlement) $
j. Is additional loss suspected? ☐ Yes ☐ No (If yes, explain)

k. Has the suspected violation had a material impact on or otherwise affected the financial soundness of the institution? ☐ Yes ☐ No (If yes, explain)

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Name of Financial Institution

Page 5 of 7

Continuation Sheet

Item No	Remarks

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Criminal Statutes

18 U.S.C. 2	"To aid, abet, counsel, command, induce or procure" the commission of federal offense.
18 U.S.C. 201	Bribery of public officials, including elected representatives, jurors and employees of any department or agency of the federal government, and witnesses in official proceedings; e.g., anyone who gives, offers or promises anything of value to a public official or a witness with the intent to influence that person's official functions.
18 U.S.C. 215	Kickbacks, bribes. Makes it unlawful for any officer, director, employee, agent or attorney to solicit, accept or give anything of value in connection with any transaction or business of any financial institution.
18 U.S.C. 371	Conspiracy of two or more persons to either commit a federal offense or to defraud the United States (or any agency of the U.S.)
18 U.S.C. 656	Theft, embezzlement or misapplication of bank funds, willfully, by an officer, director, agent or employee of a bank, with intent to injure or defraud the bank. Can infer intent to injure from the fact of injury or from acts knowingly done in reckless disregard for the interests of the bank.
18 U.S.C. 709	False advertising or misuse of words "National," "Federal Reserve," "Deposit Insurance," etc., to convey impression of federal agency affiliation.
18 U.S.C. 1001	General false statements statute—knowingly and willfully falsifying or concealing a material fact or making a false statement or making or using false writing knowing it to be false.
18 U.S.C. 1005	False entries and reports or statements, including material omissions, with intent to injure or defraud the bank, the Board of Governors (or OCC or FDIC), bank examiners or other individuals or companies.
18 U.S.C. 1014	False statement (oral or written) e.g., loan application, made knowingly for the purpose of influencing any bank whose deposits are federally insured, upon any application, purchase agreement, commitment, loan (or any change or extension of same) including willfully overvaluing land, property or security.
18 U.S.C. 1029	Credit Card fraud—knowingly and with intent to defraud, produce, use or traffic in counterfeit access devices.
18 U.S.C. 1030	Computer fraud—knowingly accessing a computer without authorization, or using it for unauthorized purposes, including obtaining information contained in records of financial institutions.
18 U.S.C. 1341	Mail fraud—scheme or artifice to defraud that makes use of the Postal Service.
18 U.S.C. 1343	Wire fraud—scheme or artifice to defraud using transmission by wire, radio or TV for the purpose of carrying out the scheme.
18 U.S.C. 1344	Bank fraud—scheme or artifice to defraud a federally insured institution or take money funds, credits, assets, securities or other property by misrepresentation.
18 U.S.C. 1621	Perjury/false statement made under oath (if false statement is not made under oath, individual may still be prosecuted under 18 U.S.C. 1001 or 1014).
18 U.S.C. 1951 18 U.S.C. 1961	Racketeer Influenced and Corrupt Organizations ("RICO") statutes. Investing in any enterprise affecting interstate commerce if the funds for the investment are derived from "a pattern of racketeering activity" (these activities are defined to include: murder, drug dealing, bribery, robbery, extortion, counterfeiting, mail fraud, wire fraud, embezzlement from pension funds, obstruction of criminal investigations, fraud in the sale of securities, etc.).
18 U.S.C. 2113	Bank robbery and incidental crimes, including taking of any property in excess of $100 in value belonging to a bank, savings and loan or credit union, and receiving, possessing or disposing of same.
31 U.S.C. 5311 31 C.F.R. 103	Currency Transactions/Bank Secrecy Act.
15 U.S.C. 78dd	Foreign Corrupt Practices Act of 1977. Payment of anything of value to any foreign official, foreign political party or candidate or "any other person where the American corporation knows or has reason to know the thing of value would be offered to a foreign official, foreign political party or candidate for foreign political office."
15 U.S.C. 78ff	Criminal violations of securities laws.
15 U.S.C. 78x	Criminal penalty provisions of securities laws.
12 U.S.C. 1847a	Willful violations of the Bank Holding Company Act and the Board of Governors' regulations promulgated thereunder.

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Instructions

Introduction: The purpose of this form is to provide a consistent means by which financial institutions can make referrals of known or suspected criminal activity perpetrated against the institutions whether by insiders or those outside the institution. The form will provide an effective means by which appropriate law enforcement and supervisory authorities will be made aware of known or suspected criminal activity. Institutions should use care in filling out this form and should ensure that it is filled out in as complete a manner as practicable under the circumstances.

THE FOLLOWING INSTRUCTIONS SHOULD BE REFERRED TO WHEN FILLING OUT THE ITEMS REFERENCED:

Item 1. State Member Banks use FDIC certificate number. Bank Holding Companies use F.R. Y-6, F.R. Y-9 BHC Number if available.

Item 2. As of end of most recent calendar quarter.

Item 3. Self-explanatory.

Item 4. Enter a check mark next to those descriptions in 4(a) which most generally describe the nature of the criminal activity. Use the list of criminal statues provided on page 6 as an aid to filling out item 4(b).

Item 5. Self-explanatory.

Item 6. Complete subparagraphs (a) through (g) on *each* individual suspected of criminal activity. This list should include primary suspects only. Individuals who may have knowledge of the suspected criminal activity, but who are not themselves suspected of being involved should be listed as witnesses under Item 14. Provide any additional details known with respect to prior referrals or affiliations.

Item 7. Provide a *brief* narrative description of the activity giving rise to the referral. For those filing the long version of this form, details will be provided later in the form. The purpose of this paragraph is to provide a *summary* description of the overall transaction.

Items 8 through 10. Self-explanatory.

Item 11. This section of the referral is critical. It should be as detailed as circumstances permit. The care with which this section is written may make the difference in whether or not the described conduct and its criminal nature are clearly understood. The discussion points listed in this section are not exhaustive. They should be covered, but to the extent an additional category should be addressed, it should be done here. Feel free to use attachments or to continue the description on a separate sheet. Include any suggestions for the interviewing of any witnesses, gathering of any documents or methods of investigation which might prove useful in following up on the referral (e.g. tracing of proceeds).

Items 12 through 16. Self-explanatory.

ADDITIONAL INSTRUCTIONS FOR EXAMINERS

Examiners should fill out this form whenever suspected criminal activity has been identified in an institution and either has not yet been reported by the institution or the referral made by the institution is deemed to be inadequate. It is important to note that the form should be filled out whenever criminal activity is suspected; examiners are not required to make any initial finding that such referrals would, if pursued, result in a criminal conviction. That judgment will be made by responsible law enforcement authorities. Any questions regarding whether or not any particular activity would constitute a crime for purposes of making a criminal referral should be resolved through communications with Board Staff.

The purpose of this referral is to provide appropriate law enforcement authorities with complete and accurate information relating to suspected criminal activity. All information requested within the body of the form should be supplied at the time of the referral unless such information is not known or can only be supplied at a later date by operation of the Right to Financial Privacy Act. In filling out of this form, examiners should avoid overly technical descriptions of transactions which might not be readily understood by law enforcement authorities unfamiliar with banking operations.

DISTRIBUTION: If made by Financial Institution

1. Retain one copy in the institution's files.
2. Send one copy to the Federal Reserve Bank in the District where your financial institution is located.
3. Send one copy to the nearest office of the FBI.
4. Send one copy to the nearest office of the U.S. Attorney.

DISTRIBUTION: If made by Federal Reserve Bank

1. Retain one copy in Reserve Bank file under name of the financial institution.
2. Send two copies to the Board of Governors, ATTENTION: Director, Division of Banking Supervision and Regulation.
3. Send one copy to the nearest office of the FBI.
4. Send one copy to the nearest office of the U.S. Attorney.

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TO: Holders of United States Attorneys Manual Title 9

FROM: United States Attorneys' Manual Staff
Executive Office for United States Attorneys

Stephen S. Trott
Assistant Attorney General
Criminal Division

RE: Policy Concerning Prosecution Under New Bank Bribery Statute (18 U.S.C. §215)

NOTE:
1. This is issued pursuant to USAM 1-1.550.
2. Distribute to Holders of Title 9.
3. Insert at end of USAM Title 9.

AFFECTS: USAM 9-40.400

9-40.400 BANK BRIBERY - 18 U.S.C. §215

9-40.410 Investigative Jurisdiction

Violations of 18 U.S.C. §215 are within the investigative jurisdiction of the Federal Bureau of Investigation.

9-40.420 Supervising Section

Criminal Fraud Section.

9-40.430 Discussion of Offense

9-40.431 General

Present 18 U.S.C. §215 was created by part F of chapter XI of the Comprehensive Crime Control Act of 1984 (P.L. 98-473, title II, October 12, 1984). It is the culmination of a ten year effort to improve federal bank bribery laws and replaces former 18 U.S.C. §215 and §216 which were replete with enforcement

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problems. 1/ The offenses defined by the former sections were only misdemeanors. They did not directly cover the offerer or payer of the bribe. Section 215 only applied where the payment was a _quid pro quo_ or a precondition for a loan. They did not cover all federally insured institutions, and it was not clear that all non-loan transactions of a financial institution were covered.

9-40.432 Corrupt Bank Officer - 18 U.S.C. §215(a)

New subsection 215(a) prohibits any officer, director, employee, agent, or attorney of a financial institution, a bank holding company, or a savings and loan holding company, as defined in Section 215(c), except as provided by law, from soliciting or receiving anything of value for or in connection with any transaction or business of the financial institution. 2/ The thing of value can be for the benefit of the official or of any other person or entity (other than the financial

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1/ In this portion of the Manual dealing with section 215, the term "bank" is used generically to cover all federally regulated institutions protected under the statute. Also the terms "employee" or "officer" are meant to cover all individuals affiliated with the protected institutions as recognized by the statute.

2/ There is an apparent technical omission in both subsections (a) and (b). The "in connection with" language includes "financial institution" but omits "bank holding company" or "savings and loan holding company." Under the statute "bank holding company" and "savings and loan holding company" are defined separately from "financial institution." Therefore the statute does not presently cover bribery "in connection with" the business of a "bank holding company" or a "savings and loan holding company." The Department of Justice has proposed technical amendments to the Comprehensive Crime Control Act of 1984 to correct this omission.

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institution). Subsection 215(d) states that the salaries or fees paid by the financial institution to its own officers, employees, and agents are not encompassed within the provisions of subsection 215(a) or (b).

The term "in connection with any transaction or business of such financial institution" is more comprehensive in scope than the earlier section 215 and is based on comparable language in former 18 U.S.C. §216. See, S.Rept. No. 98-225 at 375. The new section 215 expands the concept of criminal liability beyond the simple quid pro quo formula where the favorable treatment is conditioned upon the actual or promised receipt of the bribe. Section 215 proscribes as well a bank officer's receipt of gratuities given to him for or because of his bank-related decisions or activity. The scope of section 215, therefore, parallels the scope of the gratuity provisions applicable to federal officials in section 201. 3/

9-40.433 Bribe Offerer or Payer - 18 U.S.C. §215(b)

New subsection 215(b) prohibits any person from directly or indirectly giving, offering, or promising anything of value,

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3/ 18 U.S.C. §§201(f) and (g) prohibit the giving or receipt of unlawful gratuities. Sections 201(f) and (g) do not require proof of a quid pro quo or unlawful influence. These subsections require the government to prove merely that something of value was given to a public official for or because of an official act performed or to be performed by him. The government does not have the burden of proving, as it does in the case of 18 U.S.C. §§201 (b) and (c), that the gratuity was given for the purpose of influencing that or any other official act. United States v. Neiderberger, 580 F.2d 63, 68-69 (3rd Cir. 1978); United States v. Evans, 572 F.2d 455, 481 (5th Cir.), cert. denied, 439 U.S. 870 (1978); United States v. Brewster, 165 U.S. Appeals D.C., 1, 21, 506 F.2d 62, 82 (1974).

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except as provided by law, to an official of a financial institution, bank holding company or savings and loan holding company for or in connection with any transaction or business of the financial institution. The addition of the subsection fills a major gap in the earlier section 215 which did not directly cover the offerer or payer of the bribe. The thing of value can be for the benefit of the official or of any other person or entity (other than the financial institution). Just as with subsection 215(a), the gratuity provisions of 18 U.S.C. §§201(f) and (g) provide a useful analogy with subsection 215(b).

9-40.434 Definitions - 18 U.S.C. §215(c)

New subsection 215(c) contains the definition for "financial institution," "bank holding company," and "savings and loan holding company." "Financial institutions" includes FDIC and FSLIC insured institutions, credit unions insured by the National Credit Union Administration, and other federally regulated financial institutions, such as small business investment companies, defined in the Small Business Investment Act of 1958, any Federal Home Loan bank, and any Federal land bank or land bank association, the transactions of which it is in the federal interest to safeguard. 4/ See, S. Rept. 98-225, at 375-376.

4/ Although members of the Federal Reserve System are not expressly covered, any state bank, which handles deposits as part of its normal services and which is a member of the Federal Reserve System, will be insured by the FDIC and, therefore, will be a "financial institution" within the meaning of section 215(c). Similarly, "financial institution" does not expressly cover a "national bank," but every national bank is insured by the FDIC.

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There is an apparent technical omission in subsection 215(d). This subsection states that the thing of value either offered or received by a bank officer or employee shall not include the "payment by a financial institution of the usual salary or director's fee... [or] a reasonable fee paid by such financial institution to such officer, director, employee, agent or attorney for services rendered to such financial institution." In exempting normal salaries and fees paid to bank officers, this subsection failed to include "bank holding company" and "savings and loan holding company." "Financial institution" as defined by the statute does not include holding companies. As a result, the statute on its face fails to exclude from consideration as a thing of value the salary or normal fees the officer, director, or employee receives from a bank holding company or savings and loan holding company. The Department of Justice has submitted technical amendments to the Comprehensive Crime Control Act of 1984 to correct this omission.

It should also be noted that "financial institution" as defined in subsection (c) does not include a Federal Reserve Bank. Therefore bribery of a Federal Reserve Bank officer or employee cannot be prosecuted under section 215. But a Federal Reserve Bank officer or employee is a "public official" under 18 U.S.C. §201 and can be prosecuted for bribery under that statute. United States v. Hollingshead, 672 F.2d 751, 754 (9th Cir. 1982).

9-40.435 The Elements of the Offense

There are three basic elements of the offense proscribed by section 215. In the case of subsection 215(a), the government must prove (1) an act of soliciting or receiving a thing of value

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by an officer or employee of a financial institution, bank holding company, or savings and loan holding company either for himself or a third party (other than the financial institution itself); (2) that the act of soliciting or receiving was done by the officer or employee knowingly and willfully; and (3) that the officer or employee knew that the act of soliciting or receiving was for or in connection with a transaction or business of a financial institution.

In the case of subsection 215(b), the government must prove (1) an act of offering or giving a thing of value to an officer or employee of a financial institution, bank holding company, or savings and loan holding company for the benefit of either the officer or employee himself or a third party (other than the financial institution itself); (2) that the act of offering or giving was done knowingly and willfully; and (3) that the one who offered or gave the thing of value knew that the act of offering or giving was for or in connection with a transaction or business of a financial institution.

9-40.436 Intent of the Parties

Section 215 does not expressly set forth an intent element. The Department of Justice believes that the statute will be interpreted to contain a "general intent" element, namely, that the defendant intend to do the act of soliciting or receiving, offering or giving, knowing that such act was for or in connection with a transaction or business of a financial institution. No specific intent to influence by a bribe or to be

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influenced by a bribe is necessary. Accordingly, section 215 resembles sections 201(f) and (g) of Title 18. 5/

In proving that the defendant did the act *knowing that such act was done in connection with a financial institution's business*, the government is required to prove only that the defendant did the act of giving or receiving, knowing that it was done *for or because of some financial institution related act--of either a general or specific nature--that the bank officer either has done, will do, or might do in the future*. 6/ The facts of a given case, however, may show more than section 215 requires, namely, a specific intent on the part of one or more of the parties to actually influence or be influenced by the offer or receipt of the thing of value. In such a case, the specific intent to influence or be influenced will obviously encompass the lesser intent or mental state of knowing that the act was "in connection with" bank business.

9-40.437 The Defense of "Except As Provided by Law"

Section 215 provides a statutory defense to the charge to the extent that the receipt of the thing of value is or was "provided by law." The legislative history of the statute

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5/ Whereas sections 201(b) and (c)--bribery of a federal official--are specific intent crimes, sections 201(f) and (g)--illegal gratuities--require no specific intent or quid quo pro. *United States* v. *Standefer*, 610 F.2d 1076, 1080 (3rd Cir. 1979), (en banc), *aff'd*, 447 U.S. 10 (1980).

6/ "All that was required in order to convict Standefer was that the jury conclude that the gifts were given by him [to the IRS agent] for or because of [the IRS agent's] official position, and not solely for reasons of friendship or social purposes." *United States* v. *Standefer*, *supra*, at 1080.

provides no specific guidance as to what Congress had in mind when it provided this defense.

The absence of such a statutory defense need not be pleaded in the indictment. See USAM 9-12.325 (Negating Statutory Exceptions). Any indictment should, however, charge that the conduct was done "unlawfully."

9-40.438 Penalties

Under either subsection 215(a) or (b), if the item offered or given is greater than $100 in value, the offense is a felony punishable by up to 5 years imprisonment and/or a fine of $5000 or three times the value of the bribe or gratuity, whichever is greater. If the thing of value is $100 or less, the offense is a misdemeanor punishable by imprisonment of up to one year and/or a fine of $1,000. It should be noted that under the provisions of the Criminal Fine Enforcement Act of 1984 (P.L. 98-596, Oct. 30, 1984), a higher fine may be imposed for offenses committed after December 31, 1984. Pursuant to 18 U.S.C. §3623, (1) an individual may be fined up to $250,000 for a felony and up to $100,000 for a misdemeanor which is punishable by imprisonment up to six months and (2) a corporation may be fined up to $500,000 for a felony and up to $100,000 for a misdemeanor.

9-40.439 Policy Concerning Prosecution

1. The Priority of Bank Bribery and Bank Fraud Prosecutions

For the past two years the Department of Justice has been concerned with the recent upsurge in bank failures and near failures, especially those brought about by insider fraud and misconduct. In 1984, there were 79 bank failures and 27 failures of savings and loans, an unprecedented number since the advent of federal controls in the 1930's. In the previous year, 1983, there were a total of 48 bank failures and 46 failures of savings and loans.

Congress itself was well aware of the problem. In submissions to the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Government Operations Committee in the summer of 1984, the Justice Department found that in a survey of 75 FDIC-insured banks that failed from January 1, 1980, to June 17, 1983, 61 percent of such failures involved actual or probable criminal misconduct by bank insiders. In its own estimate, the FDIC told the Subcommittee that criminal misconduct was a "major contributing factor" in 45 percent of the same 75 bank failures. Congress recognized that criminality among bank officers rarely springs from a vacuum but often evolves from cozy relationships between bank officer and customer. With this as a backdrop, Congress passed the Comprehensive Crime Control Act of 1984 which, along with other provisions, gave a new and comprehensive scope to the bank bribery statute.

United States Attorneys shall place bank fraud and bank bribery prosecutions high on their list of white collar crime enforcement priorities. The health of the nation's banking industry is essential to the health of the nation's economy. Instances of bank bribery and bank fraud, even if directed toward relatively small banks, seriously undermine the confidence and trust that individuals and businesses place in the banking

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industry as a whole. That confidence and trust will diminish all the more if the public fails to perceive a comprehensive and active federal law enforcement presence in the industry.

2. Prosecutive Policy With Respect to Individual Cases

The purpose of 18 U.S.C. §215 is to deter the payment of bribes or gratuities to officials of financial institutions and thereby to protect the integrity of such institutions and their transactions. *See*, S. Rept. No. 98-225, at 375-376 (1984). The bribery statute recognizes that officers and employees of federally insured or regulated institutions owe a fiduciary duty of honest services to their employer.

In accordance with section 215's legislative purpose of protecting against corruption in the banking and savings and loan industry, it is the Department of Justice's policy that cases prosecuted under this provision entail breaches of fiduciary duty or dishonest efforts to undermine bank transactions. Because section 215 is intended to reach acts of corruption in the banking industry, it should not be used to prosecute inconsequential conduct. For example, in the banking industry as in other industries, situations can arise that involve insignificant gift giving or entertaining that plainly do not involve a breach of a fiduciary duty or dishonesty. Typical of such situations are the occasional receipt of meals, entertainment, or other gifts of modest or nominal value where the conduct is either authorized by or disclosed to bank management. Moreover, these are situations where the size of the benefit, either offered or received, in relationship to the bank transaction or business either sought or discussed by the customer is inconsequential. Such inconsequential conduct should not form the basis for prosecution under section 215.

The following should be considered in assessing whether there is a defense to a bribery or gratuity allegation or whether the conduct is at most insignificant and does not warrant prosecution.

(a) The Applicability of a Bank's Own Standard of Conduct

Various banks on their own initiative have established, and may be expected to establish, certain guidelines or standards of conduct regarding their employees' receipt of benefits such as meals, entertainment, and gifts from bank customers. By adopting such standards a bank implicitly recognizes that a certain amount of entertainment does not amount to a corrupting influence on the bank's transactions. Consequently, a bank officer's compliance with reasonable standards of conduct of his own bank would constitute a formidable barrier to successful prosecution if the officer's conduct is ever challenged.

Senior management, however, cannot avoid the bribery statute by simply adopting for itself loose and uninhibited standards of conduct even when full disclosure is made to the bank's board of directors. The issue is one of "reasonableness." A "reasonable" standard of conduct is one which permits an employee to receive the normal amenities that facilitate the discussion of bank business, such as a business luncheon, but which excludes the receipt of those benefits which serve no demonstrable business purpose, such as a weekend hunting or fishing expedition or the receipt of scarce or expensive tickets to athletic or theatrical events. Clearly, conduct that falls squarely within reasonable standards of behavior presents no corrupting threat and is inappropriate for prosecution.

(b) Social and Family Ties of the Banker

It is not uncommon for bankers to have close social or family ties with some of those with whom they do business. Where these ties exist, gifts and entertainment may have more to do with social or family ties than with bank business. Accordingly, prosecutors shall closely examine the relationship between the bank customer and bank officer. For an analogy regarding federal employees and their social and family ties, see 28 C.F.R. §45.735-14(c)(1)-(4).

(c) The Possibility of a Clarifying Regulation

It appears that the federal supervisory agencies, such as the Federal Home Loan Bank Board, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of Controller of the Currency, or the National Credit Union Administration, through their regulatory powers regarding unsafe or unsound banking practices, may issue regulations that authorize financial institutions to regulate the receipt of nominal gratuities by a code of ethics. Such regulations, if adopted, may help clarify the situations in which, in the view of the supervisory agency, the officers and employees of financial institutions may, without running counter to the purpose of the statute, receive gratuities of nominal value or be modestly entertained by bank customers to facilitate the discussion of bank business.

If such regulations are promulgated, the Department of Justice, in adopting its own prosecutive policy under the statute, will take into account the supervisory agency's expertise and judgement in defining those activities or practices which the agency believes do not undermine an employee's or officer's fiduciary duty to the financial institution.

A similar clarifying regulation was established for federal government employees by President Johnson shortly after the enactment of the federal gratuity and conflict of interest provisions, 18 U.S.C. §§201-211. See 28 C.F.R. §45.735-14. For example, Executive Order No. 11222, 30 F.R. 6469 (May 8, 1965), as amended by Executive Order No. 11590, 36 F.R. 7831 (April 23, 1971), provides in part that:

> ...it may be appropriate to provide exceptions (1) governing obvious family or personal relationships where the circumstances make it clear that it is those relationships rather than the business of the persons concerned which are the motivating factors -- the clearest illustration being the parents, children or spouses of federal employees; (2) permitting acceptance of food and refreshments available in the ordinary course of a luncheon or dinner or other meeting or on inspection tours where an employee may properly be in attendance; or (3) permitting acceptance of loans from banks or other financial institutions on customary terms to finance proper and usual activities of employees, such as home mortgage loans.

3. Conclusion

Each United States Attorney is required to decide whether a bank employee's conduct in apparent violation of the statute is serious enough to warrant federal criminal prosecution or whether the case should be declined in favor of civil remedies.

All United States Attorneys are encouraged to communicate to state and local authorities, through their respective Law Enforcement Coordinating Committees (LECC), their understanding of the new bank bribery statute. Specifically the LECC should solicit the input of local law enforcement officials, including state regulatory officials, in an attempt to identify which local institutions or officials or which practices, if any, are suitable subjects for investigation.

In dealing with the bank bribery statute, it is likely that United States Attorneys or their Assistants will be called upon by local bankers for some guidance concerning what is or what is not acceptable practice under the statute. If this occurs, no advice, formal or informal, may be given other than to respond by stating what is contained in the United States Attorney's Manual.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 85-14 (FIS)

May 16, 1985

TO THE OFFICER IN CHARGE OF EXAMINATIONS AT
EACH FEDERAL RESERVE BANK

SUBJECT: AGREEMENTS AND RECOMMENDATIONS OF THE JUSTICE DEPARTMENT - SUPERVISORY AGENCIES WORKING GROUP

On April 2, 1985, an Agreement was signed by the Federal financial institutions supervisory agencies and the U.S. Department of Justice. A copy of the Agreement is attached for your information. It basically requires that the agencies work toward the goal of improving the Federal government's response to white-collar crime in the nation's Federally regulated financial institutions. The Agreement's primary goal is to ensure full cooperation in the sharing of relevant information amongst the agencies, subject to existing legal restrictions, so that all available information may be used in criminal, civil, and administrative proceedings. The Agreement was the result of an interagency task force on criminal misconduct at financial institutions which was created in December 1984. The task force is comprised of representatives from the Board of Governors, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the U.S. Department of Justice, and the Federal Bureau of Investigation.

The Agreement sets forth procedures for the use of a uniform criminal referral form by all of the supervisory agencies and by the financial institutions regulated by them. The form and its detailed instructions will be made available as soon as it is finalized and we can obtain the required Board and Government agency approvals. You will be receiving further information regarding the referral form as its format becomes finalized and the actual form becomes available for use. However, for your guidance, we have attached the latest version of the referral form in order to provide you with a guide to the types of information that will be required to be submitted to the criminal justice agencies in connection with future referrals.

We also want to advise you that, in conjunction with matters covered in the attached Agreement:

(1) The Justice Department has made available lists of individuals in U.S. Attorneys Offices and FBI field offices. Board staff will be keeping these contact lists updated. You are encouraged to get acquainted and maintain contact with the U.S. Attorneys and FBI managers in your District and to establish lines of communication and coordination regarding criminal referrals.

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(2) The Justice Department's Fraud Section is developing a tracking system to monitor significant criminal referrals and investigations involving Federally regulated financial institutions. Each of the regulatory agencies will also establish a computerized information system to facilitate the exchange of information between regulators and with the Justice Department, subject to the applicable legal restrictions.

(3) Our Division is currently working on a new system for all criminal referrals. The monitoring and coordinating of criminal referral matters at the Board will be handled by Susan Meyers. We are in the process of developing a new recordkeeping system that will permit us to track more effectively the criminal referrals made by Federal Reserve Banks and the State member banks. In addition, Ms. Meyers will act as liaison between the Board, the Federal Reserve Banks, the U.S. Department of Justice and the U.S. Attorneys Offices. All inquiries relating to criminal matters, including requests from U.S. Attorneys Offices for follow-up assistance from the Federal Reserve System after a criminal referral has been made, should be directed to Ms. Meyers (extension 2781).

(4) Training courses and other training resources relating to white-collar crimes involving financial institutions are and will be available to examiners and other Reserve Bank staff. This will include the upcoming special senior examiner/FBI course being held in July, the regular FBI Bank Failure In-Service course at Quantico, Virginia, which will be held periodically, and other regional training programs. This Division will continue to keep you informed as to the availability of these and other training programs for members of your staff.

(5) Ms. Meyers will soon be in contact with each Federal Reserve Bank to assist in the adoption of new criminal referral procedures and to keep you abreast of any changes and improvements in procedures and recordkeeping systems.

If any questions arise regarding these matters, please call Ms. Meyers at (202) 452-2781 or Ms. Ellett at (202) 452-3528.

William Taylor
Director

Enclosures

AGREEMENTS AND RECOMMENDATIONS OF THE JUSTICE DEPARTMENT - SUPERVISORY AGENCIES WORKING GROUP

This document embodies the areas of agreement and recommendations of the Working Group created in December, 1984, to address problems and promote cooperation toward the goal of improving the federal government's response to white-collar crime in the nation's federally-regulated financial institutions. The Working Group is composed of senior officials of the U.S. Department of Justice Criminal Division, the Federal Bureau of Investigation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board. The four named regulators of financial institutions are referred to herein as the "Supervisory Agencies."

After an initial meeting between the Attorney General and other Justice Department officials and the heads of the Supervisory Agencies, an agenda was established and the Working Group was formed to address the matters contained herein. This document represents the results of concerted effort by the Working Group to tackle and resolve issues of major significance relating to the detection, reporting and prosecution of bank-related crimes.

The Working Group has focused particularly on white-collar crimes by "insiders" of financial institutions, which have plagued a large number of institutions with resulting large losses to the FDIC and FSLIC insurance funds. In response, the Working Group has improved the entire referral system for suspected bank fraud and abuse, developed avenues for better communications, coordination, and tracking, established new training opportunities, and determined to support certain legislative proposals as set out herein. With improved cooperation overall, the Supervisory Agencies and the Justice Department will be better equipped to respond more effectively to criminal conduct involving the nation's financial institutions. Following this document is a separate summary that elaborates upon certain of the agreements and recommendations contained herein.

The Criminal Referral Process

1. The Working Group recognizes the pivotal role of the referral process in ensuring an effective law enforcement response to crimes involving financial institutions. As envisioned by the Group and set out herein, the referral process is more than simple notification; it is a procedure for notification and continuing interest and coordination in which the Justice Department enlists the help of the Supervisory Agencies to detect and understand suspected crimes, and the Supervisory Agencies regard effective criminal law enforcement as one arm of their own enforcement efforts. This process will be sustained by regular personal

contact between the parties hereto at both the national and local levels, and by a sustained interest in and attention to each other's needs.

2. The Working Group endorses the use of a uniform method for reporting suspected criminal conduct to the U.S. Department of Justice (hereafter "Justice Department" with the understanding that, unless specified otherwise, the term refers to the Department's Headquarters in Washington, D.C., the applicable U.S. Attorneys and the FBI - both Headquarters and District offices.) The Working Group has developed a uniform referral form for this purpose to be used by the Supervisory Agencies and by their regulated financial institutions. The purpose of the referral form is to promote the transfer of complete and accurate information on key points deemed most important by the Justice Department for its assessment and evaluation of possible criminal cases. In connection with the referral form, the following matters also have been agreed upon:

a. The proposed referral form has been designed so that possible crimes involving losses of less than $10,000 and not involving "insiders" may be reported on a "short-form" portion of the referral form so that the numerous cases of teller defalcations involving small amounts of loss can be reported with minimal burden to the preparer.

b. The proposed referral form will be adapted to each Supervisory Agency's particular procedures, and the Agencies will strive to assure uniformity in the form and its instructions in all substantial respects.

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c. The Working Group members will work together in an effort to obtain OMB and other required clearances for the referral form's use.

d. The Supervisory Agencies will strive to implement a regulation or other formal policy that requires their regulated financial institutions to make criminal referrals in all cases directly to the appropriate criminal authorities, with copies to their principal Supervisory Agency.

e. The Working Group will be responsible for monitoring each Agency's completion and adoption of the referral form, the referral regulation or policy statement, necessary approvals, and implementation of the form's use, with the goal of having the referral form in use by each of the Supervisory Agencies as soon as practicable.

3. The Supervisory Agencies will establish procedures to review the criminal referrals made by their regulatees and will make referrals directly where (a) the referral made by the financial institution is deemed inadequate, or (b) the suspected criminal conduct discovered by the Supervisory Agencies has not been reported by the regulatee(s).

4. The existence of the referral form shall not prevent a Supervisory Agency from making a more detailed written referral, and shall not prevent referrals by telephone or personal contact in situations where immediate contact of the Justice Department is advisable.

5. When referrals are made by the Supervisory Agencies, they shall be made at an early stage, that is, when the Agencies' representatives first obtain evidence to support a belief

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that a crime has been or may have been committed, with allowances for reasonable periods of time for review of the proposed referral under each Agency's established procedures. The referral of suspected criminal conduct shall in no way restrict the Supervisory Agencies from continuing their own examinations or investigations into the same conduct in order to carry out their regulatory responsibilities, unless they are requested to cease or suspend such activity by Justice Department representatives in connection with an ongoing criminal investigation or prosecution.

6. Following the dispatch of a criminal referral by a Supervisory Agency, that Agency shall segregate the documents and information relative to the referral or establish procedures to ensure that such documents and information are readily retrievable if the Agency is requested to produce them by the Justice Department.

7. Copies of the following types of referrals shall be forwarded to the Fraud Section of the Justice Department's Criminal Division and to the FBI Headquarters in Washington, D.C. by the Supervisory Agencies: referrals involving losses above an agreed upon amount, referrals disclosing possible crimes of particular significance to the Agencies (including criminal misconduct by "insiders" of financial institutions) or that otherwise are of national impact, and referrals that involve significant criminal conduct in more than one jurisdiction.

8. In connection with significant cases as described in the preceding paragraph, the Supervisory Agencies are encouraged to seek the active assistance of the Fraud Section. Such assistance

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should be sought, to the extent practical, at the time of or, in appropriate cases, in advance of the Agencies' referrals to the U.S. Attorneys. The Fraud Section and FBI Headquarters will assist the U.S. Attorneys in their evaluation, investigation, and/or prosecution of such significant cases, and where appropriate, will coordinate multi-jurisdictional cases. In appropriate cases, the Fraud Section also will supply prosecutorial staffing.

9. The Supervisory Agencies will strive to communicate directly with the U.S. Attorneys' offices about significant criminal referrals involving their regulated financial institutions. It is understood that oral and written communications follow-up, and coordination are encouraged between the local offices of the Supervisory Agencies and the U.S. Attorneys' and local FBI offices. These parties shall communicate their concerns about particular cases and engage in dialogue to resolve problems. Thereafter, the Justice Department Fraud Section will entertain inquiries, complaints, and "appeals" of declinations by U.S. Attorneys with respect to referrals made by the Supervisory Agencies or their regulated financial institutions on cases believed by the Agencies to be significant.

Coordination, Cooperation and Information-Sharing Between the Working Group Representatives

10. Each of the Working Group members has exchanged information that identifies appropriate points of contact (by name, address and telephone number) for making criminal referrals, for seeking assistance with investigations, and for resolving any problems with coordination. The Justice Department also has identified

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individuals in U.S. Attorneys' offices and FBI field offices who are experienced in financial institutions crimes. All Working Group members are responsible for keeping the "contact lists" updated on a reasonably current basis.

11. The Working Group members will actively encourage periodic meetings between representatives of their regional or district offices. For example, the regional management of the Supervisory Agencies are encouraged to get acquainted and maintain contact with the U.S. Attorneys and FBI managers for their region, and to explore whether there are any problems in communications or coordination that can be resolved at that level.

12. The Supervisory Agencies will review current regulations, delegations, and procedures to determine if changes are required to assure expeditious responses to requests by the Justice Department for written materials or for direct assistance by representatives of the Supervisory Agencies. If needed, appropriate changes will be made to such regulations, delegations and procedures.

13. The Working Group members will cooperate fully in the sharing of relevant information, subject only to applicable legal restrictions, and will assist one another in assuring that information so shared may be used by the recipient(s) in appropriate criminal, civil or administrative proceedings.

14. The Justice Department will implement procedures to improve its reporting of information to the Supervisory Agencies. In particular, it is agreed:

a. The disposition of criminal referrals sent to the Justice Department pursuant to paragraph 6 above, shall be reported by the Justice Department to the appropriate Supervisory Agency that forwarded the referral. In addition, U.S. Attorneys will be instructed to notify the referring Supervisory Agency of the disposition of referrals made by such Agency.

b. The Justice Department will instruct the U.S. Attorneys to notify the appropriate Supervisory Agency when indictments and convictions are returned against "insiders" or employees of financial institutions, particularly when such individuals continue to be affiliated with the financial institutions at the time of the indictments or convictions.

c. Information obtained by the Justice Department during criminal investigations will be shared with the appropriate Supervisory Agencies where such information may assist the Agencies in carrying out their regulatory responsibilities, subject only to applicable legal restrictions or where confidentiality is essential to maintain the integrity of a criminal investigation.

15. In order to assist the Justice Department in its execution of the information-sharing described in the preceding paragraph, the Working Group supports an amendment to Rule 6(e) (Fed. R. Crim. P. 6(e)), which would permit the Justice Department to petition the appropriate Court for permission to make available to the appropriate Supervisory Agency(ies) information obtained pursuant to the Grand Jury process that would assist the Agencies in carrying out their regulatory responsibilities.

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Tracking of Criminal Referrals and Investigations and Information Systems

16. The Justice Department Fraud Section will develop a tracking system to monitor significant criminal referrals and investigations involving federally regulated financial institutions:

a. This tracking system will be initiated by inputting those referrals of which copies have been sent directly to the Fraud Section pursuant to Paragraph 7 above.

b. Information from the Fraud Section's tracking system will be shared with the Supervisory Agencies, subject only to applicable legal restrictions.

17. The FBI will input all of the Supervisory Agencies' and regulated financial institutions' criminal referrals on its FOIMS computer system. Consistent with applicable legal restrictions and the need to maintain confidentiality concerning certain ongoing criminal investigations, the FBI will share information from the FOIMS system with the Supervisory Agencies.

18. Pursuant to previous agreements between the Supervisory Agencies, criminal referrals and other information about individuals are being shared by and among the Supervisory Agencies. The Agencies have agreed to coordinate this process in connection with their respective processes of computerization of information and to make such information available to one another and to Justice Department representatives upon request, subject only to applicable legal restrictions.

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Training

19. The Working Group agrees to coordinate and share training courses and other training resources in the area of white-collar crimes involving financial institutions. In particular:

a. The FBI has agreed to make at least 30 slots available for training examiners or other employees of the Supervisory Agencies in a special "Bank Failure In-Service" course, which will be presented in Quantico, Virginia, during July 1985. The FBI also will present regional training programs in which the Supervisory Agencies will participate in 1986. All such training by the FBI will focus on investigative techniques and problems in cases involving financial institutions.

b. The Supervisory Agencies will explore with the Federal Financial Institutions Examination Council ("FFIEC") whether it will assume responsibility for presenting a white collar crime course in a form similar to that currently presented by the Office of the Comptroller of the Currency ("OCC"). The Working Group members will encourage the FFIEC to present such a training course, which will be available to representatives of the Supervisory Agencies and the Justice Department.

c. While the FFIEC is considering the establishment of the white collar crime course, and/or in the event that such a course is not established by the FFIEC, the OCC will continue to make slots available to the other Supervisory Agencies and the Justice Department in its "White Collar Crime Seminar" given periodically during each year.

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d. The Justice Department will develop a training course (or a segment of a course) for Assistant U.S. Attorneys that focuses on the investigation and prosecution of white collar crime involving federally-regulated financial institutions, and will strive to make slots available to the Supervisory Agencies for appropriate representatives to attend.

The Right to Financial Privacy Act

20. The Working Group has agreed to support a clarifying legislative amendment to the Right to Financial Privacy Act of 1978 ("RFPA") (12 U.S.C. § 3401 *et seq.*) relative to transferring information to law enforcement authorities. The amendment endorsed by the Working Group is one that would permit the transfer of financial information lawfully in the possession of one government authority (such as a Supervisory Agency) to another government authority (such as the Justice Department) for a law enforcement purpose within the jurisdiction of the receiving authority, without notice to the customer.

21. The Justice Department has found that the RFPA notices to customers can be damaging to the conduct of criminal investigations. Therefore, until a clarifying amendment is enacted the Supervisory Agencies will implement procedures to ensure that criminal referrals are made in a manner that does *not* require notices to customers. Accordingly, it is anticipated that, in some instances, referrals may omit the names of significant suspects or

witnesses and/or copies of supporting documentation from protected customers' records. In such cases the Justice Department will utilize Grand Jury subpoenas to compel production of the omitted information from the Supervisory Agencies or directly from their regulated financial institutions.

22. The Working Group will, by written request to the Justice Department, seek a clarification of the May 22, 1979, opinion to Deputy Attorney General Civiletti from the Office of Legal Counsel relative to criminal referrals by the Supervisory Agencies and the requirements of the RFPA concerning customer notices in connection with such referrals.

The Bank Bribery Act

23. The Working Group has addressed numerous questions and concerns relating to the Bank Bribery Act. Pub. L. No. 98-473, § 1107, 98 Stat. 2145 (1984), 18 U.S.C. § 215. In particular, the Group is exploring the possibility of clarifying the scope of the Act by regulations or policy statements issued by the Supervisory Agencies and/or by written guidance from the Justice Department. These matters will continue to be pursued by the Working Group.

Continuation of the Working Group

24. The Working Group unanimously agrees that the communications and cooperation initiated by the Group have been positive and productive. Accordingly, the Working Group will continue to meet on a regular basis to discuss implementation of and any problems related to the matters set out herein and to share

information about specific criminal cases and other matters that may be of interest to all members of the Working Group.

Dated: 2 April 1985

U.S. Department of Justice

By: Edwin Meese III

Federal Bureau of Investigation

By: William H. Webster

Board of Governors of the
Federal Reserve System

By: Preston Martin

Office of the Comptroller of
the Currency

By: C. Todd Conover

Federal Deposit Insurance
Corporation

By: Margaret L. Egginton

Federal Home Loan Bank Board

By:

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SUMMARY OF THE RATIONALE FOR CERTAIN OF THE MATTERS SET FORTH IN THE ATTACHED AGREEMENTS AND RECOMMENDATIONS OF THE JUSTICE DEPARTMENT-SUPERVISORY AGENCIES WORKING GROUP

Each of the numbered paragraphs in the attached "Agreements and Recommendations of the Justice Department-Supervisory Agencies Working Group" represents the results of lengthy discussion and consideration by the Group. This summary does not attempt to discuss all of the reasons for the many agreements and understandings that have been reached, but only to expand upon the rationale for certain of the more significant provisions.

The Criminal Referral Process

Paragraphs 1 through 6 of the Working Group Agreements set forth procedures for the use of a uniform criminal referral form by all of the Supervisory Agencies and by the financial institutions regulated by them. The proposed form itself is the product of considerable effort by the Working Group and is designed to relay the type of information deemed most important by the Justice Department for its assessment and investigation of matters referred by the Supervisory Agencies and their regulated financial institutions. The form and its detailed instructions will assure that such referrals are an effective means of notifying criminal law enforcement authorities of suspected offenses. In particular, a referral made by use of the form will identify the suspected criminal violation both in summary and in detailed form by instructing the preparer to give a chronological and complete account of the suspected violations by relating key events and identifying significant documents and potential witnesses.

While the proposed referral form requests considerably more information than often has been provided in the past by the Supervisory Agencies and their regulated financial institutions, it is not intended to delay the referral process while all answers to the questions are gathered. (See Paragraph 5.) In fact, if certain information is not readily available to the preparer, he/she will be instructed to complete the known information and not delay the transmittal of the form. Moreover, the Working Group has designed a referral form that has a "short form" version for referrals that disclose suspected losses under $10,000 that do not involve "insiders". In terms of the volume of referrals received at this time by the Justice Department, such "smaller" crimes represent the overwhelming majority of cases reported. The "long form" version of the referral form will be utilized for all other criminal referrals by the Supervisory Agencies and their regulated financial institutions. (Paragraph 2(a).)

It is recognized that the actual approval of the form by each of the Supervisory Agencies and clearance for its use by OMB will take some time. The Working Group has agreed to cooperate fully in achieving use of the form in a substantially identical format. (Paragraph 2(b), (c), and (e).) Also key to the new referral process will be the implementation of regulations or other formal requirements by each of the Supervisory Agencies that require referrals to be made directly by their regulated

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financial institutions (Paragraph 2(d)). Only if the referrals made by the financial institutions are inadequate or if a referral has not been made by an institution, will the Supervisory Agencies make the referral directly (Paragraph 3), its being understood that the Supervisory Agencies will promptly undertake to make referrals themselves in both circumstances, and will not rely on the institutions to do so unless the Agencies are assured that the institutions have made the referrals in a satisfactory manner. This procedure was adopted in the interest of administrative economy by the Supervisory Agencies, who believe that their limited resources will better be spent preparing the limited number of referrals on such matters as serious abuse by "insiders" of financial institutions, which referrals are unlikely to be made by the institutions themselves.

The Working Group stresses that the existence of the referral form is not intended to prevent referrals by telephone or personal contact in emergency cases or any situation where the Agency believes that evidence or witnesses could disappear if there are delays in making the referral. (Paragraph 4.) Similarly, the form is not intended to deter the preparation of more detailed referrals as deemed appropriate by the Supervisory Agencies. (Paragraph 4.)

The Working Group considered whether to identify an evidentiary standard for when criminal referrals are to be made, such as when "substantial evidence" of a crime has been discovered, but determined not to do so. Often the preparers of criminal referrals are not in a position to make such determinations,

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particularly when the suspected crime requires evidence of "willfulness" or an "intent to defraud." These are decisions to be made by Justice Department representatives, who prefer to be advised of the potential crime early when it is first suspected by the Supervisory Agencies so that Justice may develop the facts toward evaluation of a criminal prosecution. Accordingly, Paragraph 5 of the Working Group's Agreements provides that referrals of suspected criminal violations shall be made at an early stage when the Supervisory Agencies first obtain evidence to support a belief that a crime has been or may have been committed.

Of particular note is the role that the Fraud Section of the Justice Department's Criminal Division has agreed to assume in the criminal referral process. (Paragraphs 7 through 9.) The Fraud Section will assist in the Department's consideration and coordination of significant referrals (Paragraph 8), and will entertain inquiries, complaints, and "appeals" by the Supervisory Agencies concerning referrals made to U.S. Attorneys' offices (Paragraph 9).

Coordination, Cooperation and Information-Sharing

Paragraphs 10 through 15 detail areas in which the Working Group has established points of contact (Paragraph 10), encouraged communications at the regional level (Paragraph 11), and agreed to improve their responsiveness to requests for information from one another (Paragraphs 12-15.) Each of the Working Group members currently has legal or procedural restrictions that limit or impede access to one another's records.

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Certain of these restrictions are statutory, such as the Right to Financial Privacy Act and Grand Jury Rule 6(e), in response to which the Working Group are supporting legislative amendments. (See Paragraphs 15 and 20.) The Working Group members will assure that any other impediments are only those actually required by law or regulation or necessary to preserve the integrity of information or investigations.

The proposed amendment to Rule 6(e) set out in Paragraph 15 would allow Justice Department representatives to petition the appropriate Court to permit the sharing of information obtained pursuant to the Grand Jury process, with the Supervisory Agencies. Often the receipt of grand jury information could facilitate the Supervisory Agencies' taking administrative or judicial action to prevent harm to financial institutions under their supervision, and/or to prevent or reduce losses to the FDIC or FSLIC insurance funds. This is particularly significant because the Justice Department may be unable to use grand jury information because it does not meet the higher standards required for criminal prosecutions or because the demands of more serious criminal cases postpone action on crimes involving financial institutions. The same information however, could be significant to a Supervisory Agency either to support civil action or to initiate its own examination or investigation of the matter.

Tracking and Information Systems Regarding Criminal Referrals and Investigations

Paragraphs 16 through 18 recite the agreements reached relative to tracking and information systems maintained about the individuals named in criminal referrals. As a result of the agreements reached in this area, all of the Working Group members will have access to valuable information in connection with carrying out their respective responsibilities. For example, the Justice Department now may be able to determine if a suspect referred by one Supervisory Agency also has been referred for a similar crime by another Supervisory Agency in another jurisdiction. (Paragraphs 16-17.) Moreover, a Supervisory Agency may be able to access material information from the Justice Department about individuals filing change in control applications with the Agency. (Paragraphs 14(c), 16 and 17.)

Training

The Working Group has agreed to coordinate and share training courses and other training resources in the area of white collar crimes involving financial institutions. In particular, the FBI already has agreed to present special training for examiners from the Supervisory Agencies, and other courses to be made available to the Working Group members are identified in Paragraphs 19(a) through (d).

The Right to Financial Privacy Act

The restrictions of the Right to Financial Privacy Act ("RFPA") have impeded the criminal referral process in a significant manner over the last several years. The Working Group members are unanimous in their belief that a clarifying amendment with respect to the customer notification requirements of the RFPA should be enacted for the transfer of information to the

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Justice Department for its use in conducting a criminal investigation or prosecution. (Paragraph 20.) The current customer notice provisions of the RFPA are ill-advised in two major respects. When customers who are "victims" or who are otherwise uninvolved in the suspected criminal conduct, receive notice under the RFPA upon transfer of their financial records to the Justice Department, it causes unnecessary confusion and concern. However, when the suspected perpetrator of the crime receives such a notice, the Justice Department is concerned that he may take action to destroy evidence or otherwise to cover-up his wrongful conduct.

Because of these problems, the Working Group's Agreements provide that the Supervisory Agencies will implement procedures to ensure that criminal referrals are made in a manner that does not require notice to customers. (Paragraph 21.) This will sometimes result in referrals that omit the names of customers or copies of customer records of "protected" customers when the referrals are made, and which will require the issuance of Grand Jury subpoenas to obtain the omitted information without customer notice. However, the Working Group has agreed to operate under this procedure until and unless a corrective amendment to the RFPA is enacted. This does not mean that referrals will be abbreviated by not explaining fully the suspected crime; rather, the referral will omit identifying the protected customer or financial records only, and will otherwise report all of the pertinent facts requested on the referral form.

Equally important is the fact that the Working Group members have agreed to support a clarifying amendment to the RFPA that would provide an exception to the customer notice requirements for any transfers of information lawfully in the possession of one government authority (i.e., a Supervisory Agency) to another government authority (i.e., the Justice Department) for a law enforcement purpose. (Paragraph 20.)

The Bank Bribery Act

Paragraph 23 points out that the Working Group has addressed and will continue to pursue issues related to the new Bank Bribery Act at 18 U.S.C. § 215.

Continuation of the Working Group

Finally, the Working Group has agreed to continue its existence in order to complete the implementation of the matters agreed upon and to serve as a continuing *ad hoc* committee to discuss problems and to resolve matters of common interest and responsibility. (Paragraph 24.)

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April 26, 1985

SAMPLE REFERRAL FORM March 15, 1985

1. NAME, LOCATION, AND CHARTER NUMBER OF THE FINANCIAL INSTITUTION

   a. ____________ b. ____________ c. ____________
   (Name) (Address) (Charter #)

2. ASSET SIZE OF THE FINANCIAL INSTITUTION $____________

3. APPROXIMATE DATE AND PROBABLE DOLLAR AMOUNT OF THE SUSPECTED VIOLATION

   a. ____________ b. ____________
   (Date) (Dollar Amount)

4. SUMMARY CHARACTERIZATION OF THE SUSPECTED VIOLATION (Check appropriate box or boxes)

   a. Defalcation/Embezzlement ____________
   False Statement ____________
   Check Kiting ____________
   Bribery/Gratuity ____________
   Misuse of Position of Self-Dealing ____________
   Mysterious Disappearance ____________
   Other (Describe) ____________
   ____

   b. Applicable Section(s) of Title 18, United States Code (If known) ____________

5. THIS MATTER IS BEING REFERRED TO THE FBI IN ____________ AND THE UNITED
   (City) (State)
   STATES ATTORNEY IN ____________
   (City)
   ____________ IN ____________.
   (State) (Judicial District)

6. PERSON(S) SUSPECTED OF CRIMINAL VIOLATION

a. Name ______________________________
Address ___________________________
Date of Birth (if known) ___________________
SSN: (if known) ____________________________

b. Relationship to the community or employment
____

c. Relationship to the financial institution (officer, director, employee, agent, broker, borrower, saver, etc.)

____

d. Is the suspected person still affiliated with the financial institution? (Y/N) ___________

e. If not, when and how terminated? ____________
____

f. Have there been any prior referrals (or related referrals) on the above individual(s)? (Y/N) _____

If so, identify them. _________________________

g. Is the suspected person affiliated with any other financial institution or other business enterprise? (Y/N) ____________

If so, identify.

____

7. EXPLANATION OF THE SUSPECTED VIOLATION:

a. Give a brief summary of the suspected violation, explaining briefly what is unusual or irregular about the transaction.

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b. Give a chronological and complete account of the suspected violation.
   - o Relate key events to documents and attach copies of those documents.
   - o Explain who benefited, financially or otherwise, from the transaction, how much, and how.
   - o Furnish any explanation of the transaction provided by the suspect and indicate to whom and when it was given.
   - o Furnish any explanation of the transaction provided by any other person.
   - o Furnish any evidence of cover-up by the suspect or evidence of an attempt to deceive federal or state examiners or others.
   - o Indicate where the suspected violation took place (e.g., main office, branch, other).
   - o Recommend any further investigation that might assist law enforcement in fully examining the potential violation.

c. Indicate whether the suspected violation appears to be an isolated incident or whether it relates to other transactions.

8. EXCLUSION OF INFORMATION FROM THE REFERRAL

Has any pertinent information been excluded from this referral as a result of any legal or other restraint? (Y/N) ____________

If so, why? __________________

Has the excluded information or documents been segregated for later retrievel? (Y/N) ______________

9. WITNESSES

List any witnesses who might have information about the suspected violation and describe their position or employment. Indicate if they have been interviewed.

NAME	POSITION	ADDRESS	TELE.	INTERVIEW (Y/N)

10. DISCOVERY AND REPORTING

a. Who discovered the suspected violation and when?

b. Has the suspected violation been reported to the Board of Directors? (Y/N) _________ By whom and when?

c. Has the Board of Directors taken action? (Y/N) _______ If so, what and when?

d. Has the suspected violation previously been reported to federal or local law enforcement or to any federal or state supervisory agency? (Y/N) ________ If so, by whom, to whom, and when?

11. LOSS

a. Amount of loss known $ __________________________

b. Restitution by __________________________________

In the amount of $ ______________________________

c. Settlement by Surety Company $ ________________

d. Total restitution and settlement to date

$ ____________________________________

e. Total loss to date $ __________________

f. Name of Applicable Surety Bond Company

____

g. Amount of Bond $ ______________________

h. Amount of deductible $ ________________

i. Was claim filed? (Y/N) _________

j. Is additional loss suspected? (If yes, explain)

____

k. Has the suspected violation had a material impact on or otherwise effected the financial soundness of the institution? If so, please explain.

____

12. PREPARED BY ____________________ Position __________________

Phone no. ______________________ Agency/Institution ___________

DATE __________________________

13. OFFER OF ASSISTANCE

The individuals listed below are/will be authorized to discuss this referral with FBI and Department of Justice officials and to assist in locating or explaining any documents pertinent to this referral, provided that contact is first made with ________________ Position ______________ Phone No. _________________.

_________________________ Tele. No. _________________

_________________________ Tele. No. _________________

_________________________ Tele. No. _________________

April 26, 1985

INSTRUCTIONS FOR EXAMINERS
"CRIMINAL REFERRAL FORM"

Introduction: This form should be filled out whenever suspected criminal activity has been identified in a banking institution and either has not yet been reported by the institution or the referral made by the institution is deemed to be inadequate. Examiners are expected to report all such activity on this form and forward same to their District Counsel as soon as practicable. It is important to note that this form should be filled out whenever criminal activity is suspected; examiners are not required to make any initial finding that such referrals would, if pursued, result in a criminal conviction. That judgment will be made by responsible law enforcement authorities. Any questions regarding whether or not any particular activity would constitute a crime for purposes of making a criminal referral should be resolved through communications with District Counsel.

The purpose of this referral is to provide appropriate law enforcement authorities with complete and accurate information relating to suspected criminal activity. All information requested within the body of the form should be supplied at the time of the referral unless such information is not known or can only be supplied at a later date by operation of The Right to Financial Privacy Act. In the latter case, documents not provided with this form should be segregated and safeguarded in order that they might be subsequently supplied in accordance with the provisions of The Right to Financial Privacy Act. In filling out this form, examiners should avoid overly technical descriptions or transactions which might not be readily understood by law enforcement authorities unfamiliar with banking operations.

When and How to Fill Out This Form:

- If suspected criminal activity involves actual or probable loss or mysterious disappearance of less than $10,000 (prior to any recovery or reimbursement) not involving an executive officer, director or principle shareholder of the institutions within the meaning of 12 CFR §215, fill out only Items 1 through 7a, 12 and 13.

- If suspected criminal activity involves actual or probable loss or mysterious disappearance of $10,000 or greater (prior to any recovery or reimbursement), or involves an executive officer, director or principal shareholder of the institution within the meaning of 12 CFR §215 (regardless of the amount of loss), fill out all Items requested.

THE FOLLOWING INSTRUCTIONS SHOULD BE REFERRED TO WHEN FILLING OUT THE ITEMS REFERENCED ON THE FORM:

Items 1 through 2. Self-explanatory.

Item 3. Probable dollar amount of loss should reflect total loss prior to any allowance for restitution or recovery.

Item 4. Enter a check mark next to those descriptions in 4(a) which most generally describe the nature of the criminal activity. Refer to Appendix A to this form for a list of criminal statutes as an aid to filling out Item 4(b).

Item 5. Self-explanatory.

Item 6. Complete subparagraphs (a) through (g) on each individual suspected of criminal activity. This list should include primary suspects only. Individuals who may have knowledge of the suspected criminal activity, but who are not themselves suspected of being involved should be listed as witnesses under Item 9. If necessary, use the continuation sheet supplied.

Item 7(a). Provide a brief narrative description of the activity giving rise to the referral. Details will be provided later in the form. The purpose of this paragraph is to provide a summary description of the reason for the referral.

Item 7(b). THIS SECTION OF THE REFERRAL IS CRITICAL. It should be as detailed as circumstances permit. The care with which this section is written may make the difference in whether or not the described conduct and its criminal nature are clearly understood. The discussion points listed in this section are not exhaustive. They should be covered, but to the extent additional explanation would be useful as to any particular item or to the extent an additional category should be addressed, it should be done here. Include any suggestions for the interviewing of any witnesses, gathering of any documents or methods of investigation which might prove useful in following up on the referral (e.g., tracing of proceeds).

Item 7(c). Self-explanatory.

Items 8 through 10. Self-explanatory.

Item 11. Items (a) through (k) are self-explanatory. The amount of loss referred to in Item (e) is arrived at by deducting any amounts paid in the form of restitution or settlement from the amount of the known loss.

Items 12 through 13. Self-explanatory.

DISTRIBUTION BY EXAMINER:

Retain one copy in field office file under name of the institution.

Send all remaining copies to the District Office, ATTENTION: District Counsel.

DISTRIBUTION BY DISTRICT OFFICE AFTER REVIEW:

1. Retain one copy in District Office under name of the institution.

2. Send one copy to the nearest office of the FBI and the U.S. Attorney. If also a criminal violation of state law, consider sending the referral to the appropriate state prosecuting authority).

3. If referral involves an executive officer, director or principle shareholder within the meaning of 12 C.F.R. 215 or if losses are expected to exceed $10.000 dollars, send one copy to the Director, Enforcement and Compliance Division, Washington, D.C. 20219.

4. Send one copy to the nearest U.S. Attorneys Office with jurisdiction over the subject of the referral if referral is of the type described in immediately preceding paragraph.

All referrals forwarded to the Enforcement and Compliance Division should be accompanied by a cover letter signed by the District Counsel. In appropriate cases, the cover letter should indicate any priority to be given the referral.

April 26, 1985

INSTRUCTIONS TO FINANCIAL INSTITUTIONS "CRIMINAL REFERRAL FORM"

Introduction: The purpose of this form is to provide a consistent means by which financial institution can make referrals of known or suspected criminal activity perpetrated against the institutions whether by insiders or those outside the institution. The form will provide an effective means by which appropriate law enforcement and supervisory authorities will be made aware of known or suspected criminal activity. Institutions should use care in filling out this form and should insure that the form is filled out in as complete a manner as practicable under the circumstances.

THE FOLLOWING INSTRUCTIONS SHOULD BE REFERRED TO WHEN FILLING OUT THE ITEMS REFERENCED ON THE FORM:

Items 1 through 2. Self explanatory.

Item 3. Probable dollar amount of loss should reflect total loss prior to any allowance for restitution or recovery.

Item 4. Enter a check mark next to those descriptions in 4(a) which most generally describe the nature of the criminal activity. Refer to Appendix A to this form for a list of criminal statutes as an aid to filling out Item 4(b).

Item 5. Self- explanatory.

Item 6. Complete subparagraphs (a) through (g) on each individual suspected of criminal activity. This list should include primary suspects only. Individuals who may have knowledge of the suspected criminal activity, but who are not themselves suspected of being involved should be listed as witnesses under Item 9. Provide any additional details known with respect to prior referrals or affiliations. Item 6(b) is intended to elicit information concerning the individual's status in the community, e.g., officer or director of a local business, public official, etc.

Item 7(a). Provide a brief narrative description of the activity giving rise to the referral. Details will be provided later in the form. The purpose of this paragraph is to provide a summary description of the overall transaction.

Item 7(b). THIS SECTION OF THE REFERRAL IS CRITICAL. It should be as detailed as circumstances permit. The care with which this section is written may make the difference in whether or not the described conduct and its criminal nature are clearly understood. The discussion points listed in this section are not exhaustive. They should be covered, but to the extent additional explanation would be useful as to any particular item or to the extent an additional category should be addressed, it should be done here. Feel free to use attachments or to continue the description on a separate sheet. Include any suggestions for the interviewing of any witnesses, gathering of any documents or methods of investigation which might prove useful in following up on the referral (e.g., tracing of proceeds).

Item 7(c). Self-explanatory.

Item 8 through 10. Self-explanatory.

Item 11. Items (a) through (k) are self-explanatory. The amount of loss referred to in Item (e) is arrived at by deducting any amounts paid in the form of restitution or settlement from the amount of the known loss.

Item 12 through 13. Self-explanatory.

Distribution:

1. Retain one copy in institution's files.

2. Send one copy to District Administrator, Office of the Comptroller of the Currency.

3. Send one copy to the nearest office of the FBI and the U.S. Attorney.

4. If referral involves an executive officer, director or principle shareholder within the meaning of 12 CFR §215, or if losses exceed $10,000, send one copy to Director, Enforcement & Compliance Division, Office of the Comptroller of the Currency, 490 L'Enfant Plaza, SW, Washington, D.C. 20219.

5. Send one copy to the nearest U.S. Attorneys Office with jurisdiction over the subject of the referral if referral is of the type described in immediately preceding paragraph.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SR 85-22 (FIS)

DIVISION OF BANKING
SUPERVISION AND REGULATION

August 16, 1985

TO THE OFFICER IN CHARGE OF EXAMINATIONS
AT EACH FEDERAL RESERVE BANK

SUBJECT: Criminal Referral Procedures and the Bank Bribery Statute

For many years, the Federal Reserve System has had procedures for referring suspected criminal offenses to the Federal Bureau of Investigation and the Department of Justice. These procedures were originally set forth in SR-579, dated December 12, 1979. An Agreement signed earlier this year (see SR 85-14 (FIS), dated May 16, 1985) between the Federal financial institutions regulatory agencies and the Department of Justice committed the agencies, among other things, to work toward (1) the rapid investigation of possible criminal matters by bringing them to the attention of the Department of Justice and FBI as early as possible and (2) the development of a uniform criminal referral form that provides the specific information needed to determine whether a matter warrants investigation or prosecution or both. In accordance with these commitments, a new criminal referral form has been developed. Accordingly, we have modified our criminal referral procedures in order to implement the new form. The following will describe the new form and procedures.

CRIMINAL REFERRAL FORM

The new Criminal Referral Form was developed by an interagency task force, working under the direction of the Department of Justice, for use by all federally supervised financial institutions in reporting any suspected or known criminal activity. The Federal Reserve System's version of this form--FR 2230--has been designed so that one form can be used for all reports. Suspected criminal activity involving less than $10,000 and not involving an executive officer, director, or principal shareholder of the institution can be reported by simply completing the first two pages of Form FR 2230. If the suspected criminal activity involves an actual or probable loss of $10,000 or more or, in any case, involves an executive officer, director or principal shareholder of the institution, all items on the form must be completed.

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Enclosed is the second original of the Federal Reserve System's new Criminal Referral Form. This form is to be used in all instances where criminal activity is suspected or known in any financial institutions supervised by the Federal Reserve System. This form should be filed by the financial institution itself or by the Reserve Bank if the institution fails to do so. Please see that all State member banks, bank holding companies and Edge Act corporations supervised by the Federal Reserve System and located in your district are notified of their responsibility to file these reports and receive copies of the new form.[1]

FILING OF THE CRIMINAL REFERRAL FORM

The instructions on the Criminal Referral Form direct the filing institution to send a copy to the FBI and the nearest U. S. Attorney's office as well as the Reserve Bank. The Reserve Bank staff should then forward two copies to the Board. A computerized system is being developed for use by the Division of Banking Supervision and Regulation that will permit the Board to track criminal referrals made by Federal Reserve Banks and State member banks, bank holding companies and Edge Act corporations. Criminal referrals and related matters should be forwarded to Susan Meyers in the Division of Supervision and Regulation, who will act as coordinator for all criminal referral matters at the Board. Ms. Meyers will review all referrals received, have the data entered into the computer system, assist in the coordination of any related administrative enforcement actions, and provide any follow-up assistance required from the Federal Reserve System after a criminal referral is made.[2]

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[1] At this time, Board staff does not intend to propose to the Board a regulation requiring the filing of a criminal referral form by a financial institution subject to our jurisdiction. It is the duty of a financial institution to make an immediate written report to the appropriate U. S. Attorney, FBI and the Federal Reserve Bank in the district where the financial institution is located concerning a crime, suspected crime or unexplained loss suffered by the institution and the duty of a financial institution to facilitate the prosecution of those committing crimes against it. We do not believe that the issuance of a regulation requiring this type of action is necessary. Our experience has shown that most financial institutions do presently make appropriate criminal referrals, and, in those rare instances when referrals have not been made because, for example, of insider-related abuses, the existence of such a regulation would not have prompted the institution to make a criminal referral relating to its own activities.

FEDERAL BANK BRIBERY LAW

In an effort to improve Federal bank bribery laws, 18 U.S.C. 215 was recently amended as part of the Comprehensive Crime Control Act of 1984. New subsection 215(a) makes it a crime for an officer, director, or employee of a bank and/or bank holding company to directly or indirectly solicit or accept anything of value from anyone in connection with any transaction or business of the financial institution. Most violations of the statute constitute a felony.

The new subsection 215(a) expands the concept of criminal liability beyond the simple quid pro quo formula where favorable treatment is conditioned upon the actual or promised receipt of the bribe. This section generally proscribes a bank officer's receipt of the bribe and a bank officer's receipt of gratuities given to him or her because of his or her bank-related decisions or activities.

New subsection 215(b) prohibits any person from giving, offering or promising anything of value, except as provided by law, to an official of a financial institution, bank holding company, or savings and loan holding company. This subsection fills a gap in the earlier section 215 which did not cover the offerer or payer of the bribe.

The staffs of the Board of Governors and the Federal Reserve Banks should not be involved in the official interpretation of this new criminal statute. That responsibility rests solely with the Department of Justice; and, in this regard, we note that the Department of Justice recently released a new portion of its U. S. Attorney's manual relating to this law. We have attached its new policy guidelines for your information.

After your review of the Department of Justice's policy guidelines, you will find that this statute is apparently intended to prevent a payoff to bank officials as a quid pro quo or as a gratuity in support of a particular transaction and probably not intended to proscribe the receipt of gratuities or favors of nominal value when it is clear that the customer is not trying to exert influence over a bank official in connection with a transaction and the gratuity or favor is unsolicited. However, since we are dealing with a criminal statute subject to the interpretation of the Department of Justice, we recommend that in the event that you are contacted regarding this new law you advise the bank or bank holding company that it should consult with its counsel or the Department of Justice. In the same regard, we note that in the event that you discover, during an examination or inspection, deficiencies with respect to an institution's internal procedures relating to employee codes of conduct and ethics that could possibly be inconsistent with the new bribery law, you should recommend to the institution that it consult with counsel and seek to amend its internal ethics codes so that they are consistent with the Department of Justice's policy guidelines. Such amendments should probably include guidelines covering the total bar on soliciting or receiving anything of value as a quid pro quo or as a gratuity in connection with a transaction as well as a definition of what constitutes a gift or gratuity of "nominal value". Ethics codes should also include guidelines requiring employees to disclose to supervisors or management the receipt of anything of value and the establishment of a written report or log of all gifts or gratuities in any form that could be made available for supervisory review by the Reserve Bank at any time.

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[2] In the event that a criminal referral form prepared by a financial institution or a Federal Reserve Bank relates to violations of the Bank Secrecy Act, the Division of Banking Supervision and Regulation staff will also be responsible for forwarding the referral form to the appropriate offices of the U. S. Department of the Treasury and Internal Revenue Service.

If any questions arise regarding these matters, please call Mr. Biern at (202) 452-2620, Ms. Meyers at (202) 452-2781 or Ms. Ellett at (202) 452-3528.

WILLIAM TAYLOR
Director

Attachments

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SR 86-7 (FIS)

DIVISION OF BANKING
SUPERVISION AND REGULATION

January 24, 1986

To The Officer In Charge Of Examinations
at Each Federal Reserve Bank

Subject: Updated Criminal Referral Procedures

Background

On August 16, 1985, the Division of Banking Supervision and Regulation forwarded copies of Form FR 2230, Criminal Referral Form, to all Federal Reserve Banks (see SR 85-22 (FIS)). The new Criminal Referral Form was developed by an interagency task force working under the direction of the Department of Justice. This task force continues to meet to address problems relating to the reporting of criminal activity on the Criminal Referral Form.

The purpose of this letter is to bring to your attention some developing interpretative and procedural matters relating to criminal referrals and the use of the new form. As further described below, some of these matters will have to be communicated to the financial institutions in your district.

De Minimus Violations and Credit Card Fraud

In the months since Form FR 2230 was distributed, several questions have arisen regarding (1) crimes where a

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financial institution has no basis for identifying a possible suspect or the suspected crime involved some minimal amount and (2) credit card-related crimes. We asked the Department of Justice for clarifications in these areas, and it provided us with the following instructions:

> (1) When a financial institution concludes that a crime has probably occurred involving less than $2,500 where the institution has no basis for identifying a possible suspect or group of suspects (as often occurs with check forgery or an unauthorized use of a credit card), then reporting the violation to the United States Attorney and federal law enforcement officials is optional. But reporting is mandatory if (a) the apparent crime involves $2,500 or more or (b) the institution has a reasonable basis for identifying the suspect or group of suspects, regardless of the dollar amount involved in the apparent crime.
>
> (2) In cases involving the unauthorized use of a credit card or credit card number (18 U.S.C. 1029) or computer fraud (13 U.S.C. 1030), perpetuated without any apparent complicity of a bank employee or officer, the financial institution should send the referral form to the local office of the Secret Service in lieu of sending the referral to the FBI.

Filing Procedures

Board staff received a number of inquiries from Federal Reserve Banks regarding the proper procedures for filing the Criminal Referral Form. For your convenient reference, we note the following required procedures:

(1) When the referral is made by a Federal Reserve Bank, copies of Form FR 2230 are sent to the Board of Governors,

the nearest office[*/] of the FBI, and the nearest office of the U.S. Attorney.

(2) When the referral is made directly by the financial institution, copies are sent to the Federal Reserve Bank in the district where the financial institution is located, the nearest office of the FBI, and the nearest office of the U.S. Attorney.

(3) When a Federal Reserve Bank receives a referral that was made by a financial institution, its staff retains a copy for the financial institution's file at the Federal Reserve Bank, and it should forward a copy of the referral to the Division of Banking Supervision and Regulation for Board records.

(4) If a Federal Reserve Bank has knowledge that a financial institution has not filed a Criminal Referral Form with the FBI and the U.S. Attorney, the Federal Reserve Bank should itself make any necessary referral.

Each Federal Reserve Bank should also remind the financial institutions in its district that all criminal referrals should be made on Form FR 2230. While most financial

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[*/] The term "nearest office" refers to the office of the FBI and U.S. Attorney nearest the financial institution, not to the office nearest to a Federal Reserve Bank.

institutions are using the new form, a significant number of referrals are still being received that do not utilize the new form.

Bank Robbery

Questions have been received regarding the inclusion of the bank robbery statute (18 U.S.C. 2113) on page 6 under the list of Criminal Statutes on Form FR 2230. In general, reports of crimes that fall under this statute should not be made on Form FR 2230 since they are covered by Regulation P of the Board of Governors. However, if an officer, director, employee, or other "insider" of a financial institution is thought to be a participant in the criminal activity, the financial institution should file a report on Form FR 2230.

Bank Secrecy Act Violations

The Division has received a number of inquiries regarding possible violations of the Bank Secrecy Act where a series of deposits are made at an institution in amounts near, but not in excess of, the $10,000 reporting requirement level (for example, where a series of deposits are received in amounts of $9,900), or where there is other suspicious activity involving large amounts of cash. In these cases, financial institutions should be advised that where they supect that this law is being violated, the institutions should make the appropriate referrals by filing Form FR 2230, which will, in

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turn, be forwarded to Board staff. Division staff will then take the responsibility for forwarding any referral form involving a violation of the Bank Secrecy Act to the appropriate offices of the U.S. Department of the Treasury and the Internal Revenue Service.

Notification of Financial Institutions

Each of the matters set forth above should be brought to the attention of the financial institutions in your district as expeditiously as possible. Particular emphasis should be given to the *de minimus* exception to the reporting requirements (e.g., a crime involving less than $2,500 with no apparent suspect) since this one area has been the most troublesome to the banking community.

If your have any questions, please call Herb Biern (ext. 2620) or Susan Meyers, who is acting as coordinator for all criminal referral matters at the Board (ext. 2781). Also, please forward to Ms. Meyers, for Board records, a copy of your correspondence to the financial institutions in your district relating to this matter.

WILLIAM TAYLOR
DIRECTOR

CROSS REFERENCE: 85-22 (FIS)

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Mr. McCollum. It bothers me that even three or four banks' attorneys object to providing that information. Sounds like if you have several hundred who are willing to do that, we still have a problem with somebody interpreting the act differently than the broad interpretation.

Governor Seger. Again, I am not a lawyer but as I understand it, various States have different State laws that enter into this also.

Mr. McCollum. Perhaps we ought to provide an override to make it very clear that regardless of State laws that the information at least on this form assuming we agree that it is the kind of information we want revealed should be provided.

I want to ask you about penalties under the Bank Secrecy Act. The punishment to the bank for not complying is only possible, there has to be willful intent. My understanding is that in reality that that is almost always missing and while people have been, banks have been given fines, and quite steep fines they have accepted that rather than contest it.

My question to you is, should we not change the statute in the area of the bank secrecy fines so that you can have a fine at some level for negligently failing to report. Right now there is no standard of that nature in the act. It is willful.

Would you have a comment on that?

Governor Seger. I think I would rather provide you with that answer rather than give an off the cuff answer.

Mr. McCollum. I would like to have that answer.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MARTHA R. SEGER
MEMBER OF THE BOARD

July 1, 1986

The Honorable Bill McCollum
House of Representatives
Washington, D.C. 20515

Dear Mr. McCollum:

During the hearing before the House Banking Committee on May 14, you asked that I respond to the following question:

> "Should we not change the statute in the area of the bank secrecy fines so that you can have a fine at some level for negligently failing to report. Right now there is no standard of that nature in the Act. It is 'willful'."

I am pleased to enclose a copy of the response to your question, which I am also forwarding to the Committee for inclusion in the record.

Please let me know if I can be of further assistance.

Sincerely,

Martha R Seger

Enclosure

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In response to a question from Congressman McCollum, Governor Seger subsequently furnished the following response for the record:

I would generally defer to the opinion of the Departments of Treasury and Justice on such a law enforcement issue, since they are the primary enforcement agencies for the Bank Secrecy Act. One thing, however, that is troubling about the concept of a fine for negligently failing to report is that I fear that it might, in practice, result in penalties to banks for clerical errors and omissions in CTR filings that may occur despite a bank's best efforts to comply with the Bank Secrecy Act.

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Mr. McCollum. Second, the bankers will say later today in their testimony that they would like a provision in the law that would grant them immunity if they discover an error in failing to report Bank Secrecy Act provisions, and they report it themselves.

Would you favor or oppose an immunity for a bank that voluntarily discloses a failure to report?

Governor Seger. I must say as a citizen, I would feel that makes sense. If someone does a self-analysis, steps forward and says, you know, we have goofed, we have missed these, we have not carried out this responsibility the way we should but we are coming clean, I think they ought to be treated in a different way than someone who has had to be caught.

Mr. McCollum. The last area I would like to ask you about deals with the Treasury subpoena powers. I don't recall in looking at your testimony and hearing what you have said this morning that you commented on the request that the Treasury Department has made for being given broader powers than they now have to get at the records when they are looking for compliance directly at the Treasury Department.

My understanding is that some of the agencies that come under the supervision for bank reporting purposes do have powers but that the Treasury Department inhouse does not. Does the Fed have any objections to our giving them the broader powers they are requesting?

Governor Seger. I think I will turn that over to Mr. Biern, too.

Mr. McCollum. If Mr. Biern wouldn't mind responding, I would appreciate it.

Governor Seger. I couldn't remember that we had an objection but he just said we don't. We do not.

Mr. McCollum. You don't. Good.

Governor Seger. We do not have an objection.

Mr. McCollum. That covers the questions I wanted to ask. I yield back, Mr. Chairman, thank you.

Chairman St Germain. Governor Seger, I have additional questions I would like to submit in writing, and as I stated, I agree with you in quite a few instances, but I am not too sympathetic to the change on the international basis, to the international branches doing business over there.

But other than that, we are pretty much in sync. So we want to thank you. We will submit additional questions to you in writing and hopefully we will be with you a week from tomorrow in the great State of Rhode Island. We are one of the smallest States with one of the biggest names.

By the way, you will be in my congressional district as well, Newport.

Governor Seger. I know that, that is why I need to go.

Chairman St Germain. Thank you.

I hope you come up to testify more frequently. You are very, very vibrant and you did a good job.

Governor Seger. Thank you.

[The following correspondence contains Chairman St Germain's written questions and Governor Seger's responses:]

FERNAND J. ST GERMAIN, RHODE ISLAND, CHAIRMAN
FRANK ANNUNZIO, ILLINOIS
CARROLL HUBBARD, JR., KENTUCKY
DOUG BARNARD, JR., GEORGIA
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U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
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DOUG BEREUTER, NEBRASKA
STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

May 23, 1986

The Honorable Martha R. Seger
Member, Board of Governors
Federal Reserve System
Washington, D.C. 20551

Dear Governor Seger:

The Subcommittee appreciates your appearance at our hearings on May 14. Your testimony is of great assistance in our review of the Bank Secrecy Act and other pertinent issues.

There are several questions which the Subcommittee would like to have you answer and which will be submitted for the record. They are as follows:

1. You mention on pages 14 and 15 of your testimony that the representative of the Federal Reserve to the Basle Supervisory Committee sought to raise the issue of money laundering through the international banking system informally to the Committee at its June 1985 meeting. You state further that the Fed's representative plans to use part of the June 1986 Committee meeting to discuss possibilities for greater international cooperation and communication.

   What possibilities does the Federal Reserve have in mind to specifically increase international cooperation and communication in combatting money laundering? What arrangements, besides mutual assistance treaties, already exist and are in use?

2. On page 14 of your testimony, you state that "the Federal Reserve stands ready to assist the Justice Department by making quick referrals of suspected criminal activity to the appropriate authorities and by providing advice on international transactions."

   Can you provide specific instances of when and how the Federal Reserve has assisted the Justice Department with such referrals and advice on international transactions? What input does the Fed provide to Justice and/or Treasury on the Fed's monitoring of suspected criminal activity?

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3. The 1984 Interim Report of the President's Commission on Organized Crime chronicles in detail the important roles Panama and Hong Kong play as financial centers for drug-related money laundering activities originating in the United States.

   What is the Federal Reserve doing to encourage those governments and financial communities to eradicate or reduce money laundering? What steps are planned to aid those countries in cracking down on such activities?

4. On pages 9 and 10 of your testimony, you stated, in a footnote, that because of a recent decision in the U.S. Court of Appeals Congress may wish to consider legislation clarifying the bank regulatory agencies' enforcement authority against certain individuals.

   Could you please explain the need for such a clarification? Does the Federal Reserve have any proposed language prepared to clarify this situation?

Again, the Subcommittee is appreciative of your efforts in this area. Please submit your responses to the Subcommittee no later than June 4, 1986.

Sincerely,

Fernand J St Germain
Fernand J. St Germain
Chairman

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

July 10, 1986

MARTHA R. SEGER
MEMBER OF THE BOARD

The Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions Supervision,
  Regulation and Insurance
Committee on Banking, Finance and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

Thank you for your letter of May 23 containing written questions in connection with the hearing held on May 14. I am pleased to enclose my responses to the questions for inclusion in the record of the hearing.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,

Martha R Seger

Enclosure

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Governor Seger subsequently submitted the following in response to written questions from Chairman St Germain in connection with the hearing held before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance on May 14, 1986:

Question 1: You mention on pages 14 and 15 of your testimony that the representative of the Federal Reserve to the Basle Supervisory Committee sought to raise the issue of money laundering through the international banking system informally to the Committee at its June 1985 meeting. You state further that the Fed's representative plans to use part of the June 1986 Committee meeting to discuss possibilities for greater international cooperation and communication.

What possibilities does the Federal Reserve have in mind to specifically increase international cooperation and communication in combatting money laundering? What arrangements, besides mutual assistance treaties, already exist and are in use?

Answer: Because the practice of money laundering is international in scope, any effective initiative to eliminate or reduce the opportunity for money laundering within the U.S. banking system must be tied into a global effort. As I noted in my testimony, it is our view that the most effective means of assisting international enforcement efforts is through initiatives such as mutual legal assistance treaties between law enforcement authorities.

At the same time, the Federal Reserve can, and has, raised the issue of money laundering in bank supervisor meetings in order to increase awareness of the problem. Most recently, during a meeting of international supervisors in Washington, explanations were offered about the nature of concerns about money laundering in this country, notably the use of banks internationally as a means of legitimizing the funds of organized crime and as conduits for transfers of drug money. In this connection, specific mention was made of the role of U.S. supervisory authorities in policing reporting requirements on cash transactions at banks and of some of the problems encountered in fulfilling this role. The increasing interest of the Congress in involving U.S. bank supervisors in this problem was also noted.

In general, the response was one of sympathetic awareness by supervisors about a problem that infects most of our societies. Many characterize the problem in a broader sense as that of "economic crime", going beyond organized crime and the drug business to encompass all types of illegal activities that can benefit from the use of international banking transactions. Nevertheless, supervisors generally have limited powers vis-a-vis the affairs of bank customers. Banks themselves are expected as a general rule to be careful in their choice of bank depositors; but it is recognized how difficult this is to do, particularly when international customers and international transfers of funds are involved.

While a consensus exists that further exploration of the problem can be pursued on a bilateral basis, the discussions that have been held suggest a marginal role for collective action by bank supervisors. Most supervisors have responsibilities to inform their law enforcement agencies when they encounter transactions of uncertain legitimacy. Many are bound by secrecy laws from transmitting any such information to other than their own national law enforcement authorities. Consequently, these supervisors believe that international cooperation must take place largely between law enforcement authorities. It is in this connection that the utility of mutual assistance treaties or other forms of international agreements is particularly critical.

I know of no formal arrangements other than mutual assistance treaties that deal with the problem of enforcement. Means exist, however, for informal exchanges of information between supervisors, both in their regular activities and through discussions such as the one described.

Question 2: On page 14 of your testimony, you state that "the Federal Reserve stands ready to assist the Justice Department by making quick referrals of suspected criminal activity to the appropriate authorities and by providing advice on international transactions."

Can you provide specific instances of when and how the Federal Reserve has assisted the Justice Department with such referrals and advice on international transactions? What input does the Fed provide to Justice and/or Treasury on the Fed's monitoring of suspected criminal activity?

Answer: A uniform criminal referral form was developed by the Justice Department/Regulatory Agency Bank Fraud Working Group for the use of each of the regulatory agencies. In August 1985, the Board distributed the form to the financial institutions subject to its jurisdiction (e.g., State member banks, bank holding companies, nonbank subsidiaries of bank holding companies, and Edge Act corporations). The new form is being used successfully, and already approximately 425 criminal referrals have been made using the form.

Senior staff in the Enforcement Section of the Division of Banking Supervision and Regulation of the Board have been assigned to monitor criminal referral activity. The staff is now responsible for reviewing every criminal referral form submitted to the Federal Reserve System. Computer systems have been developed to track the referrals and cross check the referrals with the activities of the Enforcement Section of the Division. In this manner, we are better coordinating the actions that must be taken in those instances where a suspected criminal activity affects the safety or soundness of a financial institution or an individual's conduct warrants both criminal referral and removal or other formal supervisory action.

Board staff cooperated with the Department of Justice in the development of procedures designed to ensure that criminal referrals involving "significant" activities that may affect the safety or soundness of a bank or holding company or otherwise involve large sums are submitted directly to the Fraud Section of the Department of Justice for appropriate high level attention by the Department, the U.S. Attorneys' Offices and the FBI. To date, about 10 matters have been referred by the Federal Reserve System to the Justice Department for action. Included in the already referred "significant" cases was a very significant matter involving several banks and savings and loan associations and numerous individuals along with their related interests, which included some off-shore entities. Federal Reserve System examiners prepared the referral and assisted in the presentation of the matter to the Justice Department and the FBI. Since this matter is under active investigation by the FBI and a U.S. Attorney's Office at this time, we cannot provide any details of the referral.

Question 3: The 1984 Interim Report of the President's Commission on Organized Crime chronicles in detail the important roles Panama and Hong Kong play as financial centers for drug-related money laundering activities originating in the United States.

What is the Federal Reserve doing to encourage those governments and financial communities to eradicate or reduce money laundering? What steps are planned to aid those countries in cracking down in such activities?

Answer: Hong Kong has had a long standing laissez-faire policy regarding financial institutions and individual financial transactions. This policy is beginning to change, partly as a result of some recent well publicized failures of commercial banks and deposit taking companies. Increased supervisory attention is being given to commercial banks and deposit taking companies activities. More intense scrutiny over banking transactions should make the environment less hospitable to money laundering. The Federal Reserve will continue to advise the Hong Kong authorities when requested and if necessary. Hong Kong authorities are, however, initiating their own efforts to strengthen supervision over banking transactions.

Panama, on the other hand, has very rigid deposit secrecy laws which are intended to help promote its growing financial sector. It would be a long and difficult process to convince the appropriate authorities that more rigid supervision is both necessary and desirable. Nevertheless, the Federal Reserve will continue to monitor the activities of U.S. banks operating in Panama to ensure that proper internal controls and audits are in place that reduce the probability that money laundering is inadvertently occurring through U.S. banks.

The Federal Reserve, while not prescribing a set agenda in this regard, continues to be willing to assist any country that seeks aid in instituting measures that are designed to eradicate or reduce money laundering.

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Question 4: On pages 9 and 10 of your testimony, you stated, in a footnote, that because of a recent decision in the U.S. Court of Appeals Congress may wish to consider legislation clarifying the bank regulatory agencies' enforcement authority against certain individuals.

Could you please explain the need for such a clarification? Does the Federal Reserve have any proposed language prepared to clarify this situation?

Answer: Recently, in Larimore v. Conover, Nos. 84-1971, 1972, 1973, 1974 (7th Cir., April 30, 1986), the Seventh Circuit Court of Appeals concluded that section 8(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)(1)) did not allow the Comptroller of the Currency in an administrative cease and desist proceeding to hold directors who knowingly violate statutory loan limits responsible for the substantial injuries they caused a national bank. In contrast, the Ninth Circuit Court of Appeals in del Junco v. Conover, 682 F.2d 1338 (9th Cir. 1982), cert denied, 459 U.S. 1146 (1983), upheld a virtually identical order imposing such liability. Because of this discrepancy, we believe that it is important for Congress to clarify the meaning of section 8(b)(1). The amendment to section 8(b)(1) would overturn the Larimore decision and would uphold the ruling of the del Junco court and would provide generally that reimbursement is one form of affirmative action that the banking agencies may order to redress violations of law and unsafe or unsound practices.

Under an amendment to section 8(b)(1), the financial institutions regulatory agencies would have broad discretion to determine which remedies are appropriate in correcting conditions, such as losses, that result from wrongdoing. When directors or others associated with a bank or bank holding company knowingly violate the law or knowingly engage in unsafe or unsound practices, they could be held responsible for the injuries they cause to the banking institutions.

Board staff believes that the wording of any proposed amendment to section 8(b)(1) should be worked out jointly amongst the agencies. However, as a preliminary suggestion, we submit the following draft amendment to section 8(b)(1) to the Subcommittee so that it can ascertain the scope of our request:

Amendment

> Section 8(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)(1)) would be amended by deleting the "." at the end of 1818(b) (1) and inserting in lieu thereof ", including, without limitation, reimbursement, restitution, rescission or other action the appropriate Federal banking agency deems appropriate. The authorities granted to the Federal banking agencies under this section shall be in addition to, and not restricted by, any other authority provided by federal or state law."

Chairman **St Germain**. After the departure of Governor Seger, we will ask our panel to ensconce themselves at the witness table. The angel of doom is putting out the name plates. She is called this because she is the one that gives "the time is expired" notes up here.

I would say to the panel that it is important that you get close to the microphone. You have to get real close to them so that they function properly.

Our first witness on this panel—we will put all your statements in the record, incidentally, without objection. Our first witness will be James Harmon, Jr., the former Executive Director of the President's Commission on Organized Crime. Mr. Harmon, you may proceed.

STATEMENT OF JAMES D. HARMON, JR., FORMER EXECUTIVE DIRECTOR, PRESIDENT'S COMMISSION ON ORGANIZED CRIME

Mr. **Harmon**. Thank you, Mr. Chairman.

With your permission, Mr. Chairman, members of the subcommittee, I will summarize the main points of my statement which you have placed into the record.

At the outset I think it is important to express my personal thanks and the thanks of the members of the President's Commission on Organized Crime and the staff for the extensive work and commitment that the full committee has shown and this subcommittee has shown to a very crucial subject, that is efforts to strike at the profits, at the economic base of organized crime.

I think that the public will long owe you a debt for crafting the tools which law enforcement can ultimately use to get at organized crime in all its forms.

Money laundering is very important to organized crime. In a study done by the Commission we determined that organized crime's net income as $42 billion a year. Resulting in a very substantial and measurable economic impact; minimally $6 billion lost in revenues through tax evasion; a loss of 394,000 jobs in our legitimate economy; reduction of the gross national product of over $17 billion, and an increase in consumer prices thereby enabling organized crime to effect in a very important way the life of every man, woman, and child in the United States.

I submit to you, Mr. Chairman, that the safest way to view these figures contained in my statement is that they represent a very conservative estimate of the economic impact of organized crime.

For the moment I would like to focus on two major points which seem to be raised repeatedly by the legislation before this subcommittee.

That is first of all the flow of information between the law enforcement and financial institutions.

First of all, I think it is important to recall that the Commission has estimated $5 to $15 billion in illegal drug money alone moves into international financial channels, banks and other financial institutions, on an annual basis. This may seem like a lot of money, $5 to $15 billion. In fact for law enforcement officials charged with the responsibility of getting at these profits, it is like looking for a needle in 1,000 haystacks. They need a little bit of help. And the questions that arise from this ability to transfer information back and forth between financial institutions and law enforcement I think are these.

Does the obligation of citizenship end when a person enters the threshold of a financial institution? Why cannot financial institutions relay information of suspected criminal conduct to the appropriate authorities like any other citizen and why don't they want to be able to do that?

The current Federal scheme that attempts to strike at money laundering essentially focuses as I know you, Mr. Chairman, and members of the committee are well aware, focuses on reporting requirements. That is requirements of reporting by institutions themselves.

The anomaly which you have pointed out is that money laundering itself is simply not a Federal crime. The reason that the Commission focused on this issue among others was that the Commission believed that the result of creating a substantive money laundering offense was focus enforcement efforts on the other side of the teller's window, outside of financial institutions, on the launderers themselves rather than on the financial institutions.

The objective of a strategy in this area, an intervention strategy designed to get at the mob's profit as the Commission saw it, was to interrupt the cash-flow of organized crime in all its forms. Think of it this way if you would, Mr. Chairman, think of it as another kind of interdiction, think of it as an interdiction which does not depend on planes and boats and the commitment of the military, a kind of interdiction that can be done right here in this country, interdicting the flow of money into the coffers of organized crime.

This is the only way that I know of after 2 years of study of organized crime, Mr. Chairman, that members of the public, and the private sector can play a decisive role in combating organized crime, especially the drug trade.

With those general thoughts in mind, gone into more specifically in the course of my statement, Mr. Chairman, I would be prepared and happy to answer any questions that you or the members of the subcommittee might have.

[The prepared statement of Mr. Harmon can be found in the appendix.]

Chairman St Germain. Thank you, Mr. Harmon.

Now we will hear from Samuel Buffone, member of the White Collar Crime Committee of the American Bar Association.

Mr. Buffone.

STATEMENT OF SAMUEL J. BUFFONE, MEMBER, WHITE COLLAR CRIME COMMITTEE, CRIMINAL JUSTICE SECTION; ON BEHALF OF THE AMERICAN BAR ASSOCIATION [ABA]

Mr. Buffone. Mr. Chairman, members of the subcommittee, thank you. I would like to first relate the authority under which I offer my testimony today.

The American Bar Association's White Collar Crime Committee began its analysis of the money laundering problem in December 1984. After an extensive study by that committee, a report was prepared and forwarded to the criminal justice section of the American Bar Association, which adopted the report as its own. It was then forwarded to the full ABA, which through its House of Delegates adopted the resolution which is attached to my testimony.

The American Bar Association recognizes the pervasive nature of money laundering activities and the importance of combating them. Our recommendations support the enactment of Federal legislation which will assist Federal law enforcement agencies in combating money laundering.

While we believe that it is important to provide effective tools to combat money laundering, our review of proposed legislation has led us to the conclusion that the proposals go much farther than is necessary to provide an effective means to combat this problem. The breadth of many provisions of the proposed legislation create significant problems and do not in our view provide the most effective means for combating money laundering activities.

It is our belief that the focus should be on detection of the transactions rather than the tools available for post-detection prosecution. We have listed in our testimony available Federal criminal statutes that can be applied to money laundering once it has been detected. These shifting statutes provide a broad range of prosecutorial tools to prosecute money launderors once they are detected.

We urge the subcommittee to consider several factors. There were comments during the first witness' testimony as to the incredible backlog of information which has built up on these transactions.

We urge the subcommittee to consider increased staffing at both the Departments of Treasury and Justice. As we noted in our report, the process of investigating money laundering is a labor-intensive endeavor and we believe that if there is ever to be an effective solution the finances and personnel must be provided to these Federal agencies.

There is a 2 month or greater delay between the collection of the information and its turnover to Federal law enforcement authorities. That is too lengthy a delay.

We have offered some proposals as to how to improve the processing of that information and its turnover to law enforcement personnel. One is that the period of time for turning over information from a customer to a bank and from the bank to Federal authorities be reduced to 1 day, we have also suggested that a post card-type form be adopted which could be filled out by the customer at the time he made a cash transaction at a bank and immediately deposited in the mail by the bank.

Statements on that form could be subject to verification by bank personnel and subject to a criminal penalty under title 18, United States Code 1001 for knowingly making false statements. We have suggested that perhaps banking institutions could be required to immediately report to Federal authorities transactions which they believe are suspect through an 800 toll-free telephone number or some other means of reporting only those transactions that are so obviously suspect that Federal authorities should have immediate notification of them.

We urge increased regulation of the use of cashier checks and have suggested that cashier checks of greater than $2,000 be reported and that more than 1 day be required for the issuance of cashier checks to cut down on the kind of multiple transaction, Smurf money laundering that I know your subcommittee has heard testimony on in the past.

We have analyzed the proposed legislation and have included within our written testimony our comments. I would like to focus on several specific elements.

First, our strongest recommendation is that a traditional criminal law mens rea requirement be included in any statute. We support the mens rea requirements in H.R. 1474 and oppose any reason to know or reckless disregard standard for criminal culpability.

I listened with interest this morning to Mr. McCollum's question about whether or not there should be a negligence standard for a regulatory violation. We are not opposed to that kind of regulatory standard but are opposed to criminal applicability of such a standard.

We oppose those provisions of H.R. 2785 which would invade on the scope of State law criminal prosecutions and expand criminal jurisdiction over any State felony which had an economic motive as its end product because we recognize that any crime that has an economic motive will result in some form of financial transaction.

We are opposed to the expansion of wiretap authority which would be inherent in H.R. 2785 since the Comprehensive Crime Control Act of 1984 provided wiretap authority for any title 31 offense.

We oppose the amendment of title 18, United States Code, section 2, which would provide a new facilitating an offense provision. We note that the proposed amendment would apply not only to money laundering but to any Federal offense and would greatly modify the contours of current criminal law by subjecting any Federal criminal offense to a facilitating standard.

We oppose the amendment of rule 17C of the Federal Rules of Criminal Procedure to permit the issuance of grand jury and trial subpoenas with a restriction on the recipient of the subpoena being able to notify anyone.

This prohibition would include the ability to contact an attorney and prohibit the recipient of a subpoena from even seeking any legal advice about his obligations to comply with the subpoena.

On two final points, we object to the provisions of the proposed legislation which will create a new crime of receiving the proceeds of a criminal endeavor. We note that this would create significant sixth amendment problems for any attorney who received a fee from a client with any indication that the fee may have been derived from illegal conduct.

The administration's legislation would place the criminal attorney in a unique position. Because of the receipt of attorney/client privileged communication, an attorney who had any reason to believe that a fee proffered to him may have been the result of criminal activity would by mere receipt of the fee have committed a crime himself.

Finally, we are opposed to the expansion of in personna forfeiture. An expansion of in personna forfeiture would create problems when applied to money laundering transactions.

Thank you for the opportunity to address the subcommittee. I would be pleased to answer any questions.

[The prepared statement of Mr. Buffone can be found in the Appendix.]

Chairman St Germain. Now to Earl Hadlow.

STATEMENT OF EARL B. HADLOW, VICE CHAIRMAN AND GENERAL COUNSEL, BARNETT BANKS OF FLORIDA IN JACKSONVILLE, FL, AND MEMBER OF THE AMERICAN BANKERS ASSOCIATION GOVERNMENT RELATIONS COUNCIL

Mr. Hadlow. Thank you, Mr. Chairman.

I am Earl Hadlow, vice chairman and general counsel of Barnett Banks of Florida in Jacksonville, and a member of the American Bankers Association Government Relations Council.

We in the banking community have spoken out with a single voice, in favor of the use of the Bank Secrecy Act as a tool for Government to combat drug trafficking and organized crime.

Chairman St Germain. Is that microphone on?

Mr. Hadlow. As I said, the banking industry, has supported from the beginning the use of the Bank Secrecy Act as a tool for Government to combat drug trafficking and organized crime.

We have offered to sit down with the various Government agencies, the Treasury and others, to work out a detailed plan to attempt to make money laundering a crime and define it carefully so that it will be done with a scalpel and not with a shotgun. We have not been well received. We continue to offer possible solutions that will accomplish these ends and will protect the rights of American citizens and will permit the banking industry to function. Instead, they have regularly pointed out how poorly the banking industry has performed and how many banks have been fined for their late filings.

We think it is time to get on with the business of drafting a bill that will be, in the chairman's words, universally acceptable; a bill that will place the burden on the money launderers.

Money launderers are the criminals. They are the ones who need to have the stick taken to them and we want to assist you in getting something that will pass the Congress. Let's get on with it.

The banking industry has made a monumental effort to comply with the existing Bank Secrecy Act.

Since 1981, our bank, to give you some numbers, has filed approximately 60,000 CTR's and has established a computerized system that takes untold manpower to operate.

The IRS is half a million to a million CTR's behind in processing and that may translate into 6 months or so before they can take any action on the data that they already have. One of the reasons for that is the banking industry has been scared by the attitude of the regulators and some banks are, for example, taking their exempt lists down to zero so nobody can question them on their discretionary decisions.

We are filing reports for every cash transaction so that is the reason the number has jumped so dramatically. In any case, the banking industry is prepared to deal with the legislative solutions and get something that is universally acceptable.

There are three main issues in the various bills that have come forward. One is to create a new title 18 crime of money laundering which goes beyond the reporting of cash transactions and, essentially, makes a crime out of money getting into the banking institution through any means, if that cash can be tied to any illegal activity.

One of the most difficult jobs will be to draft legislation that is fair to everyone, including the bank teller who generally has no way in the world to determine the background behind money that is deposited.

Watching out for cash that is coming in is something that no teller can know the source and nature of every cash transaction. If you are seeking a bill that will pass and pass quickly, we believe you should not create a new title 18 crime of money laundering. Instead, you should take the existing Bank Secrecy Act and strengthen it. You should also pick up smurfing by defining structured transactions as a crime under the Bank Secrecy Act. Smurfing transactions, where someone deceives a bank or attempts to induce them into not filing the required CTR, could become a Federal crime simply amending the Bank Secrecy Act as has been done in Mr. Pickle's bill, H.R. 4573.

The banking industry would almost unanimously support that sort of bill. It is very discouraging to pick up a smurfing transaction, know that you have one, turn it in to somebody, as we now do under existing law, and have no action taken because the three Federal court decisions that have ruled that smurfing is not a violation of the Bank Secrecy Act.

A person can come in with $50,000 in his hand and deposit $9,000 and say I am leaving and I am going to go and deposit the rest of this in another branch later on that day and he has not violated the law.

Now, that sort of thing—we have been reporting these activities to the U.S. attorney and the FBI and it is simply now declared not to be illegal.

There is absolutely no need to amend the Right to Financial Privacy Act. It has not been shown to be any obstacle to law enforcement.

I think the American public would get very upset with Congress if they found that their bank records were uniformly opened without the use of the ordinary subpoena powers now available to the Government.

We would support Mr. Wortley's approach and Senator DeConcini's approach to have the Secretary of the Treasury review exempt lists.

The banks would love it because right this minute it is very difficult to get a decision from the Treasury Department on any questionable exempt customer or group of customers. If you go to them now and say what about these special cases, it is like pulling teeth to get an answer. Many banks, therefore, have stricken virtually everybody from their exempt list and the CTR flow accelerated dramatically.

Chairman ST GERMAIN. I am amazed at that because, as we saw in the *Bank of Boston* case, there were questions that came from Treasury to the Bank of Boston about certain exemptions that had been granted. So do you think it is a question of time and/or lack of personnel?

Mr. HADLOW. Time and staffing, yes.

Chairman ST GERMAIN. Well, that is Gramm-Rudman. There it is again. It is not funny. That is why we only have three microphones for four people, too.

Mr. HADLOW. They certainly have the power to respond.

Chairman ST GERMAIN. As you know, they testified that they don't want the power.

Mr. HADLOW. I heard that.

Mr. McCollum asked a question earlier about a possibility of a penalty for negligent violation. In fact, we have that now, because in every case, other than the *Bank of Boston*, a bank has been fined for violation of the Bank Secrecy Act, and the Treasury concluded that the bank was not guilty of any wiilful violation of the law, but concurrent with this conclusion levied a fine.

They publicize that fact and then go ahead and fine you anyway. So they are fining you for a negligent violation.

Chairman ST GERMAIN. Mr. Hadlow, with all due respect, and I mean that sincerely, all of these wonderful self-analyses and reports that were rendered came after the *Bank of Boston* case; did they not?

Mr. HADLOW. Yes, sir.

Chairman ST GERMAIN. And absent the *Bank of Boston* case, I wonder how many banks would have come in and said: "Well, we haven't been filing our reports."

Mr. HADLOW. Was your question after the *Bank of Boston* case how many banks did that?

Chairman ST GERMAIN. Had it not been for the *Bank of Boston* case, I wonder how many banks would have been standing in line to say: "Mea culpa, mea culpa, we haven't filed our reports."

Mr. HADLOW. It may be a little self-serving, but I think every one of them would have done it because every one of the violations——

Chairman ST GERMAIN. How many did it before the *Bank of Boston* case?

Mr. HADLOW. None; the reason is none of the banks that failed to file were aware of this 1981 change. All of the violations were the same, by the way.

Chairman ST GERMAIN. But Mr. Hadlow, the ABA, among others, had big instructions in their journals to the banks prior to the *Bank of Boston* case saying that banks are supposed to report CTR's.

We had that hearing. It was very thorough. I recommend that you read it sometime if you are having trouble going to sleep. You will find it very interesting.

There was no one in that bank, no one, reporting to anyone. Everybody said, gee, the other guy is doing it but nobody, and as a result, thereof, nobody was doing it.

Now, Mr. Brown himself heads it up. I went to the Bank of Boston recently with staff and we saw what they have now implemented, their training film, et cetera. They have done a magnificent job, but don't tell us that all of a sudden—I am not saying banks are evil—but by the same token don't make saints out of them because they just hadn't reported anything until all of the sudden in the press, they found out that the Bank of Boston had been slapped with a horrendous fine.

I am sorry for interrupting you, but that is the case.

Mr. HADLOW. Let me just pursue that one further moment.

My bank, for example, had filed by the time of the *Bank of Boston* case, it had filed 56,000 CTR's and had set up a very expensive system where we gathered in all the data on the computer from all the branches so we could aggregate them and all that sort of thing. We had missed filing 500, all of a single type and that is when we swap our own money in, when we get an aggregate of Canadian dollars—we had too many Canadian dollars—we would swap that money with a Canadian bank for American dollars.

Prior to 1981, that was exempt. It was right on the form that it was exempt. In 1981 they removed that exemption. It took the Fed, and the Treasury 1 year to change the form and during that period of time a number of banks, failed to pick up that change in the law and everyone of these transactions that the Treasury has fined these banks for has centered around that one change when that exemption was removed.

There was no culpability in any case and the Treasury will tell you that. There was no money laundering, there was not any drug trafficking, there was not anything, but a bunch of banks failed to catch that change and that was not a well-publicized change.

There were no seminars, no special releases on it. The form was finally changed a year later and there were a couple of small releases and a lot of banks just carelessly missed it. We are not saints.

Chairman ST GERMAIN. By that, do I hear that you will sue the ABA for not having their legal counsel inform you of change?

Mr. HADLOW. We would have loved to sue somebody and blamed somebody, but we don't blame anybody but ourselves.

We were definitely negligent just like everybody else by not picking it up. We are supposed to pick it up. It is our duty under the law, but we missed it.

So there is no culpability. That is the reason I answered your original question. We filed as soon as we found out about it, went back and filed those 500. We think the Bank Secrecy Act ought to be amended to make smurfing a crime. We think you can do it quickly and easily. We don't think you need a new title 18 crime because that is a difficult thing to define.

A title 18 crime endangers innocent customers unless you are extremely careful and you get the ACLU and the American Bar Association and all the people who are concerned about the customers' privacy rights. I don't think they will object at all to Mr. Pickle's bill which just simply says anybody who knowingly comes in and attempts to avoid filing the form 4789 is guilty of a crime.

So we support that. We have suggested in our testimony that banks that uncover failures to file CTR forms through internal audits and who make a good faith effort to report these failures shall not be subject to fines.

We think that would induce more of them to do more soul-searching and would be consistent with the aims of this act.

Thank you, sir.

[The prepared statement of Mr. Hadlow can be found in the appendix.]

Chairman **St Germain**. Mr. Hadlow, I compliment the banks of this country through you because, since the Bank of Boston and the awareness by financial institutions of the reporting requirements, many institutions have implemented exceptionally fine plans to comply with the act. In many instances, they have gone a step further and have become very aggressive because they now agree that it is an opportunity to stem crime and to discourage drug trafficking and avoid some taxes, among other things.

So I want to compliment you. I hope there aren't any banks left that have even negligently or nonwillfully not reported because I think they are all aware of it now and are doing a great job.

Unless there is some bank out in the hills there that is still receiving its communications by Pony Express and doesn't have television and radio, I think they are all doing a good job, and coming from me that is really something.

Mr. **Hadlow**. Thank you.

Chairman **St Germain**. Now we will hear from Lawrence Pedowitz, who represents the Committee on Federal Legislation, the Association of the Bar of the City of New York. Welcome.

STATEMENT OF LAWRENCE B. PEDOWITZ, MEMBER, FEDERAL LEGISLATION COMMITTEE, ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

Mr. **Pedowitz**. Thank you very much, Mr. Chairman.

Mr. Chairman, I am a member of the Federal Legislation Committee of the Association of the Bar of the City of New York. That association consists of approximately 15,000 attorneys, most of whom practice in the New York City area.

The association——

Chairman **St Germain**. How many?

Mr. **Pedowitz**. 15,000, Mr. Chairman. The association very much appreciates the opportunity to testify this morning and I personally appreciate the opportunity to appear.

The Federal legislation committee of our bar association has prepared a lengthy report. I hope it is also a helpful report.

It is approximately 84 pages, dealing with the pending money laundering legislation. Since neither my brief remarks this morning nor my written statement, in which we attempted to summarize the major points in our report, cover adequately the analysis that is contained in that report, we have also requested in our written statement that our report be made part of the subcommittee's record as well.

Chairman **St Germain**. Very definitely.

Mr. **Pedowitz**. Thank you very much.

We of the Federal legislation committee and the Association of the Bar have concluded that new legislation is indeed needed to combat money laundering. We are concerned, however, as is the American Bar Association, that the pending proposals, in particular H.R. 2785, the administration bill, and H.R. 1367, which contains the Organized Crime Commission's proposals, are in a number of important respects over-broad.

I should say before I comment, and I am going to only very briefly on the Right to Financial Privacy Act, that in arriving at our rather extensive conclusions, we had a broad consensus on our committee. I want to tell you that our committee consists of a broad range of individuals with a broad range of backgrounds. Our members include Federal prosecutors—a number of assistant U.S. attorneys, former prosecutors, and defense lawyers on the committee. There are also bank lawyers on the committee and a member of the staff of the American Civil Liberties Union.

I will tell you, for example, I spent 2 years as chief of the Criminal Division of the U.S. Attorneys' Office in the southern district of New York under Mr. Guiliani and Mr. Martin, his predecessor. In 1977, I was responsible for bringing down one of the very first Bank Secrecy Act criminal prosecutions against the Chemical Bank, and I might add, Mr. Chairman, that in 1978, as a consequence of the prosecution in 1977, we also saw a very substantial number of CTR's suddenly being filed by banks. The *Chemical Bank* case was also a case which made the front page of the Wall Street Journal and the other major newspapers of the United States, but the problem of noncompliance still rearose in the early 1980's.

We are very concerned on our committee that new legislation is indeed needed. The money laundering legislation that is being proposed makes a great deal of sense with certain narrowing. I was told that this committee was particularly concerned about the Right to Financial Privacy Act. I am only going to spend a minute or two on that subject and then open myself up to questions on a broad range of subjects.

The administration and the Organized Crime Commission both believe that the Right to Financial Privacy Act should be amended. They believe it should be amended to permit bank employees to let the Government know about suspected illegal activity, most particularly money laundering. That is what they are most concerned about. They are concerned that employees of banks should be permitted to do that without running afoul of the Right to Financial Privacy Act.

We agree that the Right to Financial Privacy Act should be amended, but we think the administration and the Organized Crime Commission bills go too far in trying to accomplish this purpose and farther than they need to go.

The problem, if I can state it very, very briefly, is that section 1103(c) of the Right to Financial Privacy Act seems right now to contemplate information being made available by bank employees to the Government about possible violations of law. That section provides specifically that the Right to Financial Privacy Act does not preclude financial institutions, that is banks, from notifying the Government that the institution has information that may be relevant to a possible violation of any statute. So, a bank can notify the Government that it has information that may be relevant to a possible violation of law.

The problem with the Right to Financial Privacy Act is that it does not explain what can be said to the Government when this notification occurs. For example, can a bank provide the name of the customer who is suspected of illegal activity?

That information is arguably derived from customer records, or financial records, which are covered by the Right to Financial Privacy Act and the bank could arguably, therefore, be precluded from providing that information.

Can the bank lawfully provide the number of the account that the customer is dealing with, the suspected customer is dealing with? That, too, is information derived from financial records which is covered—that is included within the definition of financial records which are protected by the Right to Financial Privacy Act.

Can the bank provide specific information about the suspected illegal activity, what is going on in that account? That arguably, too, is derived directly from the customer's financial records which are covered by the Right to Financial Privacy Act.

Banks, therefore, in our view, can justifiably be concerned that this information—all of this information they would like to turn over—is derived from financial records of the customer and, therefore, covered by the Right to Financial Privacy Act and, therefore, they can be concerned about prosecution. They can be concerned about suit by customers. There are also State privacy laws to be concerned about.

Now, the administration and the Organized Crime Commission want that information turned over, that is, information that identifies a customer, identifies the bank records and gives some information about suspected criminal activity. We think that should happen.

However, the administration and the Organized Crime Commission bill would cure this problem by effectively taking totally out of the Right to Financial Privacy Act any disclosures concerning any customer which is relevant to a possible violation of law.

As a consequence, if you look at those two bills, what could happen is a bank, if those provisions were enacted, could pack up all of the customer's financial records, all of the files, and ship them directly to the Government without running afoul of the Right to Financial Privacy Act. We think that goes too far. It goes needlessly too far.

If the Government receives information identifying the customer, identifying the accounts and briefly summarizing what the suspected illegal activity is, the Government has more than enough information to then use a subpoena or use a summons to obtain the information that is needed from the bank with the protections of the Right to Financial Privacy Act that follow from that summons or subpoena.

We have many, many other concerns about the legislation which is pending. It is all specified in our report and in our written statement.

I would be prepared to answer any questions about those particular recommendations.

[The prepared statement of Mr. Pedowitz and Jeffrey Glekel on behalf of the Association of the Bar of the City of New York can be found in the appendix.]

Chairman **St Germain**. Let's go back to the point you just made that a bank, under the proposed legislation, could just package all the records and send them on to the Government and say, "Here it is." Unfortunately, that goes too far.

Now, I think it might not go too far if there were an added element or if something was stricken from the proposed legislation.

As I recall, the proposed legislation also includes a section that exempts from liability both civil, particularly civil, the bank that turns over those type of records. Now I would like to address that.

It seems to me, and I have never practiced law to that extent—I practiced about 4 or 5 years, so it has been a long time—but it seems to me that if the bank has good reason to believe there is criminal activity, and they turn over the records, then that in itself is a defense to a suit that would be brought by the bank customer against the bank. In other words, there was cause or reason to believe that there was criminal activity going on.

What is your reaction to that?

Mr. PEDOWITZ. Mr. Chairman, I think you are absolutely right. That is what the new legislation would do. It would permit the bank to arrive at a conclusion there was suspected criminal activity and, therefore, pack up all of the customer records and send them to the Government, and then the legislation also provides that they could not be prosecuted or sued civilly by the customer.

Our concern is that that goes too far in letting the banks make decisions about how much information should be turned over to the Government. Our view is that if the legislation provides only that the bank may provide the following limited information to the Government, that information will be sufficient, and that that information is the following: The bank should be permitted to identify who the suspected customer is, to identify the accounts through which the suspected illegal activity is occurring, and to identify in a general way the nature of the illegal activity that the bank thinks is occurring.

We do not think that the bank should, of its own accord, be permitted simply to pack up the customer records, the accounts, the statements, et cetera, and send those directly to the Government. Let the Government make a judgment after seeing the limited information supplied by the bank that it wants to pursue this further.

If the Government decides to pursue it further, it can proceed by summons or it can proceed by grand jury subpoena. If it proceeds by summons, then the customer is going to get the protections of the Right to Financial Privacy Act. If it provides by grand jury subpoena, then the Right to Financial Privacy Act has no applicability anyway because grand jury subpoenas are exempt.

In short, we think there is a way of accomplishing all that the Government needs to accomplish without having as broad a provision—as broad an exclusion—as is being requested in the pending legislation.

Chairman ST GERMAIN. You have not addressed the question I asked you about whether the exemption from liability is necessary.

Mr. PEDOWITZ. I think the bank should be exempt from liability to the extent it provides only the limited information I suggested that it should be allowed to provide. Then I think it should be permitted a good-faith defense and should be exempt to that extent.

Chairman ST GERMAIN. Mr. Buffone, would you like to address that?

Mr. **Buffone**. I concur in most of what I heard, and I would defer to the extensive experience Mr. Pedowitz has had with running a grand jury. I only point out to the subcommittee that one of the effects of the proposed legislation would be to delete the requirement that information obtained actually be presented to the grand jury. That would set aside all the protections the grand jury provides for the criminally accused.

I think what is necessary in judging the need for legislation is to focus on what Mr. Pedowitz has said, and that is the Government can always come back and institute a grand jury investigation, and obtain by their broad power of subpoena all the documentation they need to fully investigate and make a prosecutorial determination.

What we are debating here is making money laundering transactions unique in that the Government would be able to go through an investigation without the benefits of grand jury protection to the right of the accused or the potential targets of the investigation.

Chairman **St Germain**. Mr. Harmon, as to the grand jury subpoena process, do you recall how many times that has been utilized? I think they had something like less than 42, and as a matter of fact, most of them were in a particular State; 10 out of 30 were in Nebraska alone. So why do you think that has been utilized in so few instances?

Mr. **Harmon**. That is the actual production of the records before the grand jury, Mr. Chairman?

Chairman **St Germain**. I misspoke. I am told that it is the notice provision that permits the prosecutors to go in and file a notice, and as a result, to be exempt from the disclosure to the customer. This I think, has only been utilized in 30-some-odd cases. That is since 1978.

Mr. **Harmon**. If I am not mistaken, there is an exemption for grand jury subpoenas with regard to the notice requirements. That is a recognition of the possibility of the destruction of records, flight, movement of assets and that sort of thing.

But to answer, if I could, Mr. Chairman, Mr. Pedowitz——

Chairman **St Germain**. Let's for a moment, but then please tell me why it has been used in so few instances.

Mr. **Harmon**. Well, as I understand it, the notice provision applies only to the use of administrative summons or subpoenas in civil matters. Under those circumstances, there is a requirement in the absence of a court order that the customer be notified.

I really can't speak to that, Mr. Chairman. I can only speak to the——

Chairman **St Germain**. What we will do is submit that to you in writing then.

Mr. **Harmon**. Fine, Mr. Chairman.

[The information referred to can be found in the appendix.]

Chairman **St Germain**. Now you can address the other point.

Mr. **Harmon**. Essentially what the Association of the Bar of the city of New York is saying is we can give you a little bit more information than financial institutions now give; however, if you want possession, physical possession of the records, a grand jury subpoena will be required. I think that that is an important acknowledgment that the interests of society do require a change of the Right to Financial Privacy Act and some additional specificity be provided to law enforcement.

However, I think there is an important issue and an intermediate step that is missed here in the process. That is, when we are talking about launderers, we are talking about highly flawed, very flexible type of operations.

Smurfs can move from place to place, as you know. They don't go to the same bank every day and they use different people at different times.

The intermediate step that I would envision is communication, open communication back and forth between law enforcement and financial institutions without the need for a grand jury subpoena.

It may be that in many, many cases that there is actually no need physically for the records themselves. There is nothing I think, and I think Mr. Pedowitz would agree to this, that a prosecutor relishes less than going through file cabinets and sometimes truckloads full of documents.

So I think the omission that might be present here, although it is an important acknowledgment there should be a flow of information, is this less formal step in the process.

I think what the bar association has pointed out here is that we will give you a little bit more information than the law now seems to permit, but we won't really give you enough to be able to move on or to do anything about until you serve a grand jury subpoena.

Now, in many, many cases, as I say, the actual records themselves may not be important and all that may be important is a lead, the ability to conduct surveillance, whether physical or electronic.

Chairman ST GERMAIN. Let's get back to my first question now that I have the act in front of me.

Section 3409, delayed notice:

> Upon application to the government authority, the customer notice required under Section 3404 of this title may be delayed by order of an appropriate court if the presiding judge or magistrate finds that, number one, the investigation being conducted is within the lawful jurisdiction of the government authority seeking the financial record; two, there is reason to believe the records being sought are relevant to a legitimate law enforcement inquiry; and, three, there is reason to believe such notice would result in the following: endangering the life or physical safety of any person, flight from prosecution, destruction or tampering with evidence, intimidation of potential witnesses, or otherwise seriously jeopardizing an investigation or official proceeding, or unduly delaying a trial or ongoing official proceeding to the same extent as the circumstances in the proceeding subparagraphs, A, application for delay must be made with reasonable specificity.

Now, here is the point I was trying to make and was making very poorly earlier. The delay notice requirement has been utilized in very few instances since 1978; as a matter of fact, perhaps only 30 times, 10 of them in Nebraska. When we inquired of the counsel for the Comptroller's Office as to why, this was the reply: "Because they have circumvented this by going through the grand jury subpoena process, and as a result, therefore, perhaps abused the grand jury subpoena process rather than going the route where you have to demonstrate that which is required." I just read this to you.

Mr. Pedowitz.

Mr. PEDOWITZ. I think two things are going on that are very important to understand with respect to those statistics. One, since a grand jury subpoena is exempt from the Right to Financial Privacy Act altogether, that particular delayed notice provision has no applicability to grand jury subpoenas, and therefore, if you are getting statistics they probably do not apply to grand jury instances. That is No. 1.

No. 2, to the extent a grand jury subpoena is being served for customer records, the bank would be free, absent an order from a Federal district court judge, to notify the customer nonetheless that the grand jury subpoena had been served.

Therefore, the statistic that you should be looking for is how many orders are being issued by Federal district court judges to banks that the grand jury subpoena should not be disclosed to the customer.

Now, that information is probably not available to the Comptroller. I don't know whether the information is available in any particular organization.

Chairman ST GERMAIN. Thank you.

Mr. Manton.

Mr. MANTON. It seems to me that Mr. Harmon from his vantage point of having concluded the work of the President's Commission on Organized Crime recommends very strict and tough new legislation making money laundering a substantive crime, whether it be with bank involvement or otherwise. It seems that the rest of the panel agrees to some extent that money laundering is a large problem, particularly in the area of drug trafficking, but would not go so far as Mr. Harmon proposes.

So there is a recognition that we need some kind of legislation. However, there are differences among the panelists as to what shape this legislation should take, and how far we should go in limiting personal and financial privacy rights.

The issue of recklessness, the issue of blind or willful blindness is something that I would like to explore. It seems to me that we do not want to prosecute innocent people. But there are some instances in which one would have to be an imbecile not to recognize that something is wrong when people bring cartons of small bills or travel bags of small bills into a bank.

How far should we go in terms of mens rea or knowledge, and where should the limits be? Anyone on the panel.

Mr. HARMON. Mr. Manton, the Commission's proposal and I think the administration's also in large measure recognizes existing law that knowledge sometimes means deliberately closing your eyes to what you know to be the case.

Frankly, the Commission's proposal came from what I saw in New York, the way in which, and the experience from which, I saw people transporting narcotics through Kennedy Airport, for example, and also airports in Florida, I am told, the way in which mules are prosecuted.

Essentially they always claim they really didn't know it was narcotics that they were transporting in one fashion or another. As you look at the law on this point, you will see that essentially this conscious avoidance of knowledge principle is used in large measure in those kinds of cases.

All the Commission did was recognize that the interdiction of money is as important as the interdiction of drugs, and therefore, the same kinds, the same standard of conduct should find expression in efforts to go after the money of organized crime.

So that is the parallel that the Commission drew in recommending, and the administration does also, recommending the codification of what is essentially already the case and giving everybody fair notice of what the law would require in this area.

Mr. **Manton**. It seems to me there are two approaches. One, is to define money laundering as a crime, whether that involves banks or not. The other is how we relate this specifically to financial institutions.

Mr. Pedowitz agreed that we have to make some changes in the Right to Financial Privacy Act, that would require a bank to turn over only limited information such as the depositor's name, account number, and a brief account summary instead of complete financial records.

However, couldn't a Federal prosecutor go to the grand jury with this limited information and get a subpoena for the complete financial records.

Mr. **Pedowitz**. I would say the following in response to that: I would very much like to have a professional prosecutor making a judgment about whether or not a matter ought to be pursued before my records are turned over to the U.S. Government by a banker. I don't understand why we should permit bankers to simply pack up a customer's financial records and turn them over to a prosecutor before the prosecutor makes a judgment about whether or not it is a matter that should be pursued.

I spent 2 years running the criminal division of the U.S. Attorney's Office in New York. We prosecuted perhaps 25 percent of the allegations that are made about individuals. Seventy-five percent of them either lack merit or are not severe enough to excite the interest of a Federal prosecutor.

In those circumstances, I would rather have a Federal prosecutor making a judgment about whether it ought to be pursued before the records get turned over.

Mr. **Hadlow**. May I interject from a banking——

Mr. **Manton**. My time has expired.

Chairman **St Germain**. Mr. Hadlow.

Mr. **Hadlow**. From a banking point of view, we certainly don't covet any sort of power that we should turn over on simply a phone call voluminous records to prosecutors. We look at it from the other side of the fence, and that is, a very aggressive prosecutor will call us up and ask us to send over virtually all the records in the bank sometimes, notwithstanding he has got to look through a card file or so.

Sometimes he will take them over there and stack them up in the corner and they will sit there for weeks. We are certainly at his mercy so we would like that power controled so we can operate the bank.

Chairman **St Germain**. Mr. Wylie.

Mr. **Wylie**. Thank you, Mr. Chairman.

This last discussion here indicates somewhat the dilemma that we face on this panel as to where we should come out.

Mr. Pedowitz, you state in your testimony on page 6, and Mr. Manton referred to this, it is unfair to prosecute someone for what they should have known but didn't, and then you state on page 7 that a party can be prosecuted if he or she has suspicions about which he then omits further inquiries, about which he then doesn't follow up on, for example.

Now, the dilemma, as I see it, is that this is often a substantive determination on the part of the bank official and we ought to give them some leeway to let us know or to let officials know if there is suspicious activity.

If a person comes in with a bag of money and said, "I just sold a boat," that could be suspicious activity, wouldn't you agree?

Mr. **Pedowitz**. Yes, I agree. I think in those circumstances the bank ought to be permitted to turn the information over in a limited way, as I have described before, to the Government if they care to. But I think the pages that you are referring to also deal with this mens rea concept that Congressman Manton was referring to and what our position is on that.

Our view is that the mens rea standard in the new money laundering bills ought to be simply knowing, that there is no need to start adding in reckless disregard or should have known concepts which are generally seen in the civil area.

The term "knowing" has been defined by 10 circuits and the Supreme Court of the United States to include the concept of conscious avoidance and willful blindness—the very concepts that the administration and the Organized Crime Commission seem to be trying to encompass within the terms they are using, "reason to know" or "recklessness."

We see absolutely no reason to expand the scope of mens rea when the word "knowing" is more than adequate. I think all an expansion would do is confuse the law and open up the possibility that an individual would be convicted for negligence—not for what he knew but rather for what he should have known, applying some sort of objective standard, and I think that would be a terrible mistake.

Mr. **Wylie**. Your testimony has been helpful and you have made some suggestions, and this is obviously a very knowledgeable panel. I want to compliment each of you for your testimony.

Does that state your position, Mr. Buffone?

Mr. **Buffone**. As to the mens rea requirement?

Mr. **Wylie**. Yes.

Mr. **Buffone**. I only reiterate that we at the American Bar Association criminal justice section view mens rea as one of the most fundamental aspects of the law. As Mr. Pedowitz has indicated, the jury is often instructed that willful blindness is a component of their determination and that they can use circumstantial evidence to establish intent. To make a leap from that to a negligence standard and reckless disregard is a significant change in the law that we strongly oppose.

Mr. **Wylie**. Mr. Harmon, in his statement, Mr. Hadlow, of the American Bankers Association, supports making money laundering a crime, but he does not feel the time is right for Congress to tackle this new criminal offense.

Part of his argument is that the process of criminalizing money laundering demands broad-based discussion on its possible ramifications and so forth.

How do you respond to that position?

Mr. **Harmon**. I can't imagine any more discussions that have been any more broad based than before this subcommittee and before the public at large. I respectfully submit the issue is ready and that the scope of organized crime activity really almost demands some sort of response to the ease with which money can be moved.

Mr. **Wylie**. Another area which has been difficult for me to sort out this morning is that the ABA, Mr. Hadlow, has suggested the civil penalties for noncompliance with the reporting requirements be waived for institutions that discover violations and promptly discloses them to the Treasury Department.

Would you have a comment on that?

Mr. **Hadlow**. I would submit that kind of issue is one that is best left with the discretion of the Secretary of the Treasury who can take into account all factors in determining whether or not a penalty should or should not be imposed.

There may be other factors in mitigation and in aggravation that the Secretary may wish to consider, for example, a past record of CTR violations. That is one best left to a case-by-case analysis by the Secretary of the Treasury.

Mr. **Hadlow**. I would like to submit, sir, that the Secretary of the Treasury's record has been 100 percent in favor of penalizing the bank, fining them anyway. That is the reason we are not——

Mr. **Wylie**. Whose record?

Mr. **Hadlow**. The Treasury.

Mr. **Wylie**. Let me ask you this. You suggest that we not have this civil penalty or it not be imposed on financial institutions, but doesn't it make more sense to prevent the crime before it takes place, and isn't there likely to be more surveillance or isn't that likely to act as a deterrent to violations of this sort of crime if we have this civil penalty provision?

Mr. **Hadlow**. We have not suggested doing away with the civil penalty. We just simply would say if there has been a good-faith on the part of the financial institution to comply, and then an internal audit uncovers inadvertent failures to file banks ought to be encouraged to come forward by not imposing a fine.

Mr. **Wylie**. You say it ought to be waived.

Mr. **Hadlow**. So far the Treasury has not shown any willingness not to fine when people come forward. Every one of us came forward voluntarily.

Mr. **Wylie**. Thank you, Mr. Chairman.

Chairman **St Germain**. Mr. McCollum.

Mr. **McCollum**. Thank you, Mr. Chairman.

At the beginning I would like to especially welcome Earl Hadlow, my friend from Florida. I don't know if the chairman is aware, though he is wearing his hat as a counsel for one of the larger institutions in the banking field, that Mr. Hadlow is a very distinguished practicing attorney and has been very active in the organized bar.

You could just as well be here wearing that hat. But we are very pleased that you are here wearing the one you are.

Mr. HADLOW. Thank you.

Mr. MCCOLLUM. I would like to ask the entire panel if any of you have seen the form that Governor Seger referred to regarding the right to financial privacy that supposedly has been promulgated for use by banks. Have any of you seen this particular form she is referring to?

Mr. HADLOW. Yes, sir, I have.

All the regulators have adopted forms that require banks now to report suspected criminal behavior and so we have in place now by regulatory fiat requirements on the banking industry to come forward whenever we have a suspected crime.

Mr. MCCOLLUM. Mr. Hadlow, are you concerned as counsel for a large institution that by complying with this form or filling the form out your bank might be violating the right to financial privacy and therefore subjected if not to formal Government sanctions to a civil lawsuit?

Mr. HADLOW. We spent about $25,000 getting legal opinions as to how precise we have to be in filing these forms, and just where we have to draw the line to avoid the possibility of a lawsuit in cases of unsuccessful prosecutions or violations of the Right to Financial Privacy Act.

So we are concerned that you have to be extremely cautious.

Mr. MCCOLLUM. I am concerned about two or three things with respect to this.

Mr. Harmon made a special point of saying in his testimony that we need to have preemption of the State right to financial privacy laws. May I assume that to the degree that preemption is narrow and applies only to those provisions of State laws that are more restrictive than Federal laws in the area, or Federal right to financial privacy law, that everyone on the panel would agree that preemption to protect the banks would be essential to any kind of revealing of information? Is there anyone who would disagree with the proposition we need some preemption in the law put into Federal law?

No one disagrees, the record can show.

I have another concern, and that deals with the good-faith defense that is in the right to financial privacy law now. Mr. Pedowitz, not to diminish the others' testimony, I want to compliment you because I have heard a lot of testimony, both in the Judiciary Committee and in this committee on the issues of money laundering. I think some of what you said today is the most lucid discussion of some of the really tough questions we face in this area. I appreciate that.

Mr. PEDOWITZ. Thank you.

Mr. MCCOLLUM. Dealing with good-faith defense—I will ask since you have been so lucid on the other, I will ask you this question—as I understand the reading of the present law, a financial institution may have a good-faith defense for turning over information if that information has been requested by certificate, whatever that is, of a Government agent or agency.

As I understand also, the concern that banks and other financial institutions have is that voluntarily turning something over doesn't give them any defense at all and even if they turn over something into the form that has been sent to them such as the one Governor Seger says, since it is not a request or specific information on a preknown instance by the Government, but rather a fishing expedition type form, that there is a concern as to whether they have any good-faith defense.

Do you have a comment on that?

Mr. PEDOWITZ. Yes, sir, in our report we actually propose specific language to amend the good-faith defense which would permit the banks to have a good-faith defense with respect to the specific information that we suggest they should be allowed to turn over.

Again, that would be the name of the customers, the account numbers and specific information about the purported violation of law that could all be derived from the financial records of the customer which are specifically covered by the Right to Financial Privacy Act.

Again, just to reiterate for a second, the definition of financial records of a customer includes information derived from the financial records which is what is creating the problem in my view.

Mr. McCOLLUM. I really like your proposal dealing with this whole area of right to financial privacy if we can craft language that specifies the descriptive language enough so they can give us not only the name and account number, but a description of the documents they have or whatever basis there is for feeling that a crime has been created, then give them a good-faith defense for turning that information, not any record but that information over, and preempting the States.

It seems to me we may have a good package with that. That is all sort of coming together in my mind. I don't know what anyone else is thinking.

I want to thank all of you for coming and testifying on this. It is a tough question and it is a very important question for us.

Thank you, Mr. Chairman.

Chairman ST GERMAIN. Mr. Wortley.

Mr. WORTLEY. Thank you, Mr. Chairman.

Mr. Harmon, you noted that Arizona recently enacted a money laundering statute. What has been the outcome of that. Have there been more prosecutions or has it served as a deterrent to money laundering or precisely what?

Mr. HARMON. I don't know the precise use to which the statute has been put, although I would point out that Arizona has adopted this reason to know standard in its money laundering legislation so that is a recognition by at least one State legislature which does have an organized crime problem—not an extensive problem—that that is the way to go with regard to a money laundering statute.

Mr. WORTLEY. Are you aware of any other States that are contemplating such action, too?

Mr. HARMON. State of California. It is fairly advanced in California. It is still on the drawing boards in the State of New York. Also as I am sure you are aware, the States of Florida and Georgia have their own currency reporting systems. Those are the only ones I am personally aware of at this point.

Mr. WORTLEY. After the money is laundered and it recycles, what percentage is actually going into legitimate business pursuits would you expect?

Mr. HARMON. Well, that is very hard to say. What I would say is that that depends on which organized crime group you are speaking about. Probably with La Cosa Nostra I would say over 50 percent of it finds its way back into legitimate business. Of course La Cosa Nostra is the organized crime group most involved in this country in infiltration of legitimate business.

So I would say at least half the laundered funds involving La Cosa Nostra finds its way back into legitimate businesses of one form or another.

Mr. WORTLEY. You say "legitimate" businesses, are you thinking in terms of ongoing commercial business or are you thinking in terms of stocks, bonds, real estate, et cetera?

Mr. HARMON. All of those things. Occasionally with stocks and bonds being used not only as a way to involve oneself in hidden ownership of businesses, but also as a means to launder money.

Mr. WORTLEY. Is much of that money going into casinos, race tracks, maybe even buying banks?

Mr. HARMON. We have seen instances of that, Mr. Wortley; in the case of casinos, however, it appears more likely that casinos are used as laundering devices and is used as a means to skim, to take money out of legitimate businesses for the La Cosa Nostra's other purposes.

Mr. WORTLEY. Thank you very much.

Mr. Pedowitz, I noticed on page 23 of your testimony you say "we do not support requiring a minimum $10,000 transaction for an offense to exist."

What do you mean by that? Would you elaborate on that a little more?

Mr. PEDOWITZ. Certainly.

We are talking specifically about money laundering, the new bill being proposed with respect to money laundering. One of our concerns has been that the way the money laundering bill is drafted by the administration that the money laundering offense would include financial transactions with nonfinancial institutions, such as lawyers, such as the local grocer, and our concern was and continues to be that if that law were to be enacted things like check forgery would suddenly become a Federal offense throughout the country through the money laundering statute.

So one of the things we toyed with in order to try to reduce the scope of this new Federal bill was the idea of putting a limit on the size of the transaction and saying no transaction less than $10,000 would be covered by a new Federal money laundering bill.

Our ultimate conclusion was that was not the way to go. The way to go was to narrow the money laundering bill to cover only transactions with financial institutions and not to cover the local grocer, not to cover the lawyer, not to cover the real estate operator. And our thought is that there has been no demonstration that the problem that the Organized Crime Commission found really extends to transactions with grocers, with lawyers and so on.

But the $10,000 reference was addressed to that particular subject and we dismissed that as a solution to the problem.

Mr. **Wortley**. When you talk about $10,000 transactions involving lawyers, are you talking about attorneys also would be coming in with cash?

Mr. **Pedowitz**. No, we had in mind specifically retainers, for example, in criminal cases. Very often these days retainers of criminal defense lawyers exceed $10,000 and certainly a very strong argument could be made under the administration bill and the Organized Crime Commission bill that that would be covered by the legislation that is being proposed.

It would also cover, for example, real estate brokers who might be selling a house to someone who is a suspected member of the Cosa Nostra. Our view was that that was not an appropriate transaction to cover.

Mr. **Wortley**. How many people you find going around with $10,000—substantial amounts of cash and putting it down as a downpayment on a house or even a retainer to their attorney?

Mr. **Pedowitz**. It is my belief that an extraordinary number of people deal in cash and an extraordinary number of these transactions occur.

Mr. **Wortley**. These are all nice, legitimate people?

Mr. **Pedowitz**. Mr. Hadlow just described 60,000 transactions involved CTR's in his banks. When we looked at the Chemical Bank in 1977 there were thousands and thousands of transactions involving cash which were not money laundering transactions. We found roughly 10 examples of washing for narcotics dealers, and we found hundreds and hundreds of transactions which were perfectly legitimate.

People go into banks, withdraw cash and pay for things with cash.

Mr. **Wortley**. Amazing. Simply amazing.

I guess I don't have any friends like that.

Mr. **Pedowitz**. No, I deal in checks myself, but an extraordinary number of people deal in cash.

Mr. **Wortley**. At least you don't have to worry about keeping your checkbook balanced.

My time is expired.

Thank you, Mr. Chairman.

Chairman **St Germain**. Thank you, Mr. Wortley.

Gentlemen, the administration bill would eliminate customer notification requirements when interagency transfers of personal records of an individual are requested. Obviously Mr. Harmon would agree with this since he helped draft the legislation.

But I would ask the remaining three witnesses what their reaction is to that. Mr. Buffone.

Mr. **Buffone**. I don't think I am prepared to comment, Mr. Chairman, because I am not familiar with that portion of the administration bill.

Chairman **St Germain**. Mr. Hadlow.

Mr. **Hadlow**. Would you repeat your question, please?

Chairman **St Germain**. It is the one that states that when there are interagency transfers of records amongst the agencies, that the customer need not be notified.

Mr. **Hadlow**. I do not know. So I will not comment.

Chairman **St Germain**. If you find the ABA does have one, would you submit one?

Mr. **Hadlow**. Yes, we will submit it in writing.

[The information referred to can be found in the appendix.]

Chairman **St Germain**. Mr. Pedowitz.

Mr. **Pedowitz**. Our committee was opposed to that change, believing that if agencies are free to move the records around, the likelihood is that the sensitivity of those records and privacy concerns that we are founded on would be reduced. We feel that to the extent the Government wants to transfer them from agency to agency, notice should go to the customer, unless the agencies are going into a court and getting a court to agree that there is no need for immediate notice and that the various reasons for delayed notice are applicable.

Chairman **St Germain**. Mr. Buffone.

Mr. **Buffone**. I think I now understand the question a little better.

We have spoken this morning at some length about the interface between the grand jury investigative process and the administrative investigative process.

The Supreme Court in the *Baggett* and *Sells Engineering* cases decided last year, determined that it was improper for information derived in the grand jury proceeding to be shuffled around the Government without a judicial determination that there was particular need for it.

We would support that position and take the realistic approach that much of the information we are talking about is going to be grand jury information.

Chairman **St Germain**. Mr. Harmon, I should allow you to comment.

Mr. **Harmon**. Yes.

Chairman **St Germain**. As to why the provision is in the legislation that was submitted.

Mr. **Harmon**. Well, Mr. Chairman, it is a further recognition of what the Right to Financial Privacy Act already says which is that there are risks of flight, risk of destruction of records inherent in the notification process and merely by transferring records to trigger what would not already exist in the way of notice requirement would undercut what the Right to Financial Privacy Act already says in the way of an exemption.

Chairman **St Germain**. However, if it is determined that a transfer should be made, doesn't this signify that there is reason to believe that there might be criminal actions involved?

Mr. **Harmon**. Yes, I would agree with that.

Chairman **St Germain**. If that is the case, isn't it burdensome to ask that the agencies then go to the court, to a judge and go through the proper channels to obtain an exemption from the notice requirement?

Mr. **Harmon**. Well, I would say that depends on the circumstances, Mr. Chairman. Just so the record is clear, we, that is the Commission, did not participate in the drafting of that specific piece of legislation.

Chairman **St Germain**. All right.

Mr. **Harmon**. The Commission really took no position on it and I take no strong position on it myself.

Chairman **St Germain**. Mr. Manton, do you have any questions?

Mr. **Manton**. No further questions.

Chairman **St Germain**. Mr. Wortley.

Mr. **Wylie**. No further questions.

Chairman **St Germain**. We want to express our appreciation to the panel. I have a number of questions that we will submit to you in writing. We would ask for your additional assistance with those and also thank you for your appearance this morning. It has been beneficial.

[The information referred to can be found in the appendix.]

Chairman **St Germain**. Hopefully this will assist us in coming up with some legislation within the jurisdiction of this subcommittee and full committee that will be meaningful without overreacting, as Mr. Hadlow said we shouldn't do.

Mr. **Hadlow**. Thank you, sir.

[The letter from Mr. Berman to Chairman St Germain dated May 13, 1986 and the prepared statement of Mr. Berman on behalf of the American Civil Liberties Union can be found in the appendix.]

Chairman **St Germain**. The subcommittee stands in recess to the call of the Chair.

[Whereupon, at 12:15 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

[Additional supplemental material supplied for the record can be found in the appendix.]

APPENDIX

FERNAND J. ST GERMAIN, RHODE ISLAND, CHAIRMAN
FRANK ANNUNZIO, ILLINOIS
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STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

April 24, 1986

Mr. Donald Ogilvie
Executive Vice President
American Bankers Association
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Ogilvie:

On May 14, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will continue its hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity.

As part of these hearings, the Subcommittee will conduct hearings on the several bills dealing with money laundering, including the Administration's bill, HR 2785. The other bills the Subcommittee intends to review are: HR 1367 (Mr. McCollum), HR 1945 (Mr. Hubbard), HR 1474 (Mr. Hughes), HR 3892 (Mr. Wortley), HR 4280 (Mr. Torres), and HR 4573 (Mr. Pickle).

The views of the American Bankers Association on these proposals would be of value to the Subcommittee in its deliberations. It is requested, therefore, that you, or your designee, appear and testify before the Subcommittee concerning these matters on May 14, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building.

In addition to the bills mentioned above, there are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

The Subcommittee would appreciate any comments or opinions which you might have with respect to the aforementioned Titles and that you believe would provide guidance to us in these matters.

Please provide the Subcommittee with 175 copies of your testimony no later than 24 hours in advance of your appearance. Please contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Chairman

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[illegible]

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NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

April 24, 1986

Samuel J. Buffone, Esq.
Asbill, Junkin, Meyers and Buffone
1607 New Hampshire Avenue, N.W.
Washington, D.C. 20009.

Dear Mr. Buffone:

On May 14, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will continue its hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity.

As part of these hearings, the Subcommittee will conduct hearings on the several bills dealing with money laundering, including the Administration's bill, HR 2785. The other bills the Subcommittee intends to review are: HR 1367 (Mr. McCollum), HR 1945 (Mr. Hubbard), HR 1474 (Mr. Hughes), HR 3892 (Mr. Wortley), HR 4280 (Mr. Torres), and HR 4573 (Mr. Pickle).

The views of the American Bar Association on these proposals would be of value to the Subcommittee in its deliberations. As the representative of the American Bar Association and also as a member of its Committee on White Collar Crime, it is requested that you appear and testify before the Subcommittee concerning these matters on May 14, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building.

In addition to the bills mentioned above, there are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

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Sincerely,

Fernand J. St Germain
Chairman

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DOUG BEREUTER, NEBRASKA
STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

April 24, 1986

Mr. Jerry Berman
Legal Counsel
American Civil Liberties Union
122 Maryland Avenue, N.E.
Washington, D.C. 20002

Dear Mr. Berman:

On May 14, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will continue its hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity.

As part of these hearings, the Subcommittee will conduct hearings on the several bills dealing with money laundering, including the Administration's bill, HR 2785. The other bills the Subcommittee intends to review are: HR 1367 (Mr. McCollum), HR 1945 (Mr. Hubbard), HR 1474 (Mr. Hughes), HR 3892 (Mr. Wortley), HR 4280 (Mr. Torres), and HR 4573 (Mr. Pickle).

The views of the American Civil Liberties Union on these proposals would be of value to the Subcommittee in its deliberations. It is requested, therefore, that you appear and testify before the Subcommittee concerning these matters on May 14, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building.

In addition to the bills mentioned above, there are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

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The Subcommittee would appreciate any comments or opinions which you might have with respect to the aforementioned Titles and that you believe would provide guidance to us in these matters.

Please provide the Subcommittee with 175 copies of your testimony no later than 24 hours in advance of your appearance. Please contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Chairman

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STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

April 29, 1986

Mr. James D. Harmon, Jr.
149 Euston Road
Garden City, New York 11530

Dear Mr. Harmon:

On May 14, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will continue its hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity.

As part of these hearings, the Subcommittee will conduct hearings on the several bills dealing with money laundering, including the Administration's bill, HR 2785. The other bills the Subcommittee intends to review are: HR 1367 (Mr. McCollum), HR 1945 (Mr. Hubbard), HR 1474 (Mr. Hughes), HR 3892 (Mr. Wortley), HR 4280 (Mr. Torres), and HR 4573 (Mr. Pickle).

As the Executive Director and Chief Counsel of the President's Commission on Organized Crime, your views on these proposals would be of value to the Subcommittee in its deliberations. It is requested, therefore, that you appear and testify before the Subcommittee concerning these matters on May 14, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building.

In addition to the bills mentioned above, there are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

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The Subcommittee would appreciate any comments or opinions which you might have with respect to the aforementioned Titles and that you believe would provide guidance to us in these matters.

Please provide the Subcommittee with 175 copies of your testimony no later than 24 hours in advance of your appearance. Please contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Chairman

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DOUG BEREUTER, NEBRASKA
STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

April 29, 1986

The Honorable Paul A. Volcker
Chairman, Board of Governors
Federal Reserve System
Washington, D.C. 20551

Dear Mr. Chairman:

On May 14, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will continue its hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity.

It is requested that you, or your designee, appear and testify before the Subcommittee on May 14, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building, to discuss the following matters.

In addition to several bills dealing with money laundering (copies of which are enclosed), there are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review. It is our intent to revisit the four titles to determine whether any of these statutes could be used or need to be strengthened to keep criminal elements from using financial institutions for their illegal gains. They are Titles I, VI, VII and XI of FIRICA.

The Subcommittee would appreciate your comments on the legislative proposals and your opinions on those titles of FIRICA which are applicable to the Federal Reserve's supervisory powers and authority, as they relate to our efforts to stem the flow of narcotics trafficking and the use of financial institutions by individuals to launder proceeds from that activity or to launder money from any other illegal source.

The Subcommittee would also be interested in hearing what role the Federal Reserve plays, if any, or should play in the exchange of information between it and other central banks and support it provides to U.S. law enforcement authorities regarding the flow of international banking transactions that would help those authorities detect, investigate and prosecute those involved in activities such as drug trafficking and money laundering.

The Subcommittee received testimony from the Assistant Attorney General for the Criminal Division of the Department of Justice, who briefed the Subcommittee on the status of the negotiations between the United States and other countries in efforts to enact a mutual legal assistance treaty. Should the central banks provide assistance to their respective countries in these deliberations, as they relate to international banking transactions?

It is acknowledged that financial institutions, both U.S. and foreign, have rapidly expanded their overseas offices. The Basle Committee, recognizing that such activity may create safety and soundness problems, attempts to deal with these concerns through efforts to coordinate bank supervision. Why shouldn't the Basle Committee, or some other international banking committee which included the Federal Reserve as a participant, provide an exchange of information on suspected illegal activities which have to rely on the international banking network as a vital support system?

The Subcommittee looks forward to the Federal Reserve's testimony and responses to the issues raised above.

Sincerely,

Fernand J. St Germain
Chairman

[illegible]

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NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

[illegible]

April 24, 1986

Jeffrey Glekel, Esq.
The Association of the Bar of
the City of New York
919 Third Avenue
New York 10022

Dear Mr. Glekel:

On May 14, 1986, the Subcommittee on Financial Institutions Supervision, Regulation and Insurance will continue its hearings on proposals to protect against financial institutions becoming havens for tax evaders, drug traffickers and launderers of funds derived from criminal activity.

As part of these hearings, the Subcommittee will conduct hearings on the several bills dealing with money laundering, including the Administration's bill, HR 2785. The other bills the Subcommittee intends to review are: HR 1367 (Mr. McCollum), HR 1945 (Mr. Hubbard), HR 1474 (Mr. Hughes), HR 3892 (Mr. Wortley), HR 4280 (Mr. Torres), and HR 4573 (Mr. Pickle).

The views of the Association of the Bar of the City of New York on these proposals would be of value to the Subcommittee in its deliberations. It is requested, therefore, that you appear and testify before the Subcommittee concerning these matters on May 14, 1986, at 10:00 a.m. in Room 2128, Rayburn House Office Building.

In addition to the bills mentioned above, there are four titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA), also known as the Safe Banking Act of 1978, which the Subcommittee intends to review and which we feel may lend support to our efforts to fight those criminals who use our financial institutions for their illegal gains. They are Titles I, VI, VII and XI (Supervisory Authority Over Depository Institutions; Change in Bank Control Act; Change in Savings and Loan Control Act; and the Right to Financial Privacy Act, respectively).

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The Subcommittee would appreciate any comments or opinions which you might have with respect to the aforementioned Titles and that you believe would provide guidance to us.

Please provide the Subcommittee with 175 copies of your testimony no later than 24 hours in advance of your appearance. Please contact Earl F. Rieger, Counsel of the Full Committee staff, if there are any questions.

Sincerely,

Fernand J. St Germain
Chairman

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NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

May 23, 1986

Mr. Earl B. Hadlow
Representative
American Bankers Association
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Attention: Mr. Charles Zuver

Dear Mr. Hadlow:

The Subcommittee appreciates your appearance at our hearings on May 14. Your testimony is of great assistance in our review of the Bank Secrecy Act and other pertinent issues.

There are several questions which the Subcommittee would like to have you answer and which will be submitted for the record. They are as follows:

1. Under current regulations, the Currency Transaction Report or CTR filing duties are placed solely upon the financial institution, not the customer. Wouldn't placing a duty also on the customer to file or to sign a sworn statement be an additional effective law enforcement tool?

2. Under current law, monetary instruments transported in violation of the CMIR reporting requirements may be seized and forfeited to the Government. No comparable provision exists for failure to file CTRs, although legislative proposals have been submitted to provide civil forfeiture authority for those transactions.

   Should seizure and forfeiture authority be extended as proposed? If so, what protections should be written into such legislation to protect an innocent victim from possible governmental abuse?

3. H.R. 2785 and H.R. 1367 would confer on the Secretary of the Treasury summons authority which would enable the Secretary to question directors, officers and employees and examine records of financial institutions. Do you favor this provision?

4. The Administration's bill (H.R. 2786) contains an amendment to the Right to Financial Privacy Act that would explicitly preempt any state laws or constitutions which may contain even more protective provisions as to a bank customer's rights to privacy in their bank records, than our federal law presently contains.

   In your opinion, is there a need for such a preemption provision? Are you aware of how many and what states have more protective right to financial privacy laws than the federal statute, or have documentation of how many prosecutorial opportunities were lost because of state right to financial privacy statutes?

Again, the Subcommittee is appreciative of your efforts in this area. Please submit your responses to the Subcommittee no later than June 4, 1986.

Sincerely,

Fernand J. St Germain
Chairman

For release on delivery
10:00 a.m., E.D.T.
May 14, 1986

Statement by

Martha R. Seger

Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions Supervision,
Regulation and Insurance

of the

Committee on Banking, Finance and Urban Affairs

United States House of Representatives

May 14, 1986

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I appreciate the opportunity to appear before the Subcommittee today on behalf of the Federal Reserve Board to discuss whether existing laws to protect our nation's financial institutions from becoming havens for tax evaders, drug traffickers and other money launderers can be strengthened and whether new laws should be enacted.

I shall begin by focusing on the Bank Secrecy Act and on the various legislative proposals to strengthen the Act. As requested, I will then discuss whether certain titles of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRICA) need to be amended to provide the banking agencies with more effective means of curbing the use of financial institutions by criminal elements for illegal gains. Finally, I will offer the Federal Reserve's views on what might be done, in cooperation with foreign central banks and international organizations, to curtail money laundering activities.

Bank Secrecy Act

The Federal Reserve, together with the other banking agencies, has the responsibility for monitoring financial institutions to determine their compliance with the Bank Secrecy Act. In this regard, the Federal Reserve monitors state member banks and Edge Act corporations, a responsibility delegated to it by the Department of the Treasury, which has primary responsibility for enforcement of the statute. Enacted in 1970, the Bank Secrecy Act, among other things, requires financial institutions to report certain currency transactions in excess of $10,000 to the Treasury Department. As you know, the reporting and record-keeping requirements of the Bank Secrecy Act were designed to frustrate criminal activities that generate large sums of cash, such as drug trafficking, by putting the spotlight on large currency transactions.

As the Subcommittee is aware, in recent years there have been an unfortunate number of instances, including some involving large banking organizations, where financial institutions neglected to report currency transactions as required by law. In most cases these violations were not due to criminal intent on the part of financial institutions, but rather to their failure to put in place or enforce controls designed to ensure that transactions covered by the Act would be properly reported.

The widespread publicity surrounding these reporting failures heightened the awareness of financial institutions as to the importance of complying with the Bank Secrecy Act. Many banks conducted in-house compliance audits to find transactions that should have been reported under the law. Many of those that did find them voluntarily admitted their failure to report the transactions and paid substantial fines. These and other institutions have since made special efforts to tighten their compliance controls. As a matter of fact, the volume of Currency Transaction Report (CTR) filings has increased dramatically.

Therefore, in my view, it is time to consider streamlining and modernizing the reporting process--especially for large institutions that must submit a high volume of CTRs to the IRS. This could include, for example, the use of computer-generated tapes and other technology to minimize the avalanche of paper. An additional benefit of such an approach might be improved compliance.

Federal agencies have also recognized that their enforcement procedures needed to be strengthened and, as a result, have made a concerted effort to improve compliance under the Bank Secrecy Act. Specifically, they have expended additional time and effort to increase the awareness of both financial institutions and examiners as to the requirements of the Bank Secrecy Act. An interagency working group, composed of representatives of federal banking and law enforcement agenices, has been strengthening enforcement procedures and improving communication and coordination among government agencies. Among other things, the group agreed recently to adopt uniform Bank Secrecy Act examination procedures. The group meets on a regular basis and will continue to explore methods to enhance the agencies' abilities to carry out their responsibilities under the Act.

In addition, the Federal Reserve has instructed its examiners to implement in-depth assessment procedures for Bank Secrecy Act compliance during all full-scope examinations. Previously, examiners conducted an in-depth review only when a preliminary assessment of a bank's internal systems revealed some reason to intensify the investigation. The Federal Reserve has also expanded coverage of the Bank Secrecy Act in its training program for bank examiners.

Proposed Money Laundering Bills

Despite improved compliance with the Bank Secrecy Act, we know that better record-keeping alone will not put an end to money laundering in this country. Those engaged in money laundering are a resourceful lot and have incentives to circumvent even the most carefully crafted rules and regulations. Indeed, the ability to circumvent the law is an essential requirement for success in drug trafficking and other such activities. The use of "smurfs" to circumvent the existing law is a case in point. (Smurfs, or "runners," are couriers who convert funds derived from illicit activities into multiple transactions each less than $10,000 in order to evade the currency reporting requirements of the Bank Secrecy Act.)

Yet efforts to curtail money laundering by making it more difficult and risky are clearly in the public interest and should continue. At present, however, the burden of the Bank Secrecy Act clearly falls more on depository institutions than on those directly involved in money laundering. While the reports required under the Act have been recently utilized to more effectively target money

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laundering, they cannot in and of themselves put an end to laundering activities. In the Board's view, it is more appropriate to strengthen enforcement through better utilization of current resources, and to strengthen prosecution by making money laundering a crime, rather than to increase reporting burdens.

Because of the link between money laundering and cash-based criminal activity, the Board supports legislative efforts to limit the use of financial institutions by money launderers. Four of the bills before the Subcommittee (H.R. 2785, 1367, 1474, and 1945) would make money laundering a federal crime. This would approach the problem more directly; under present law, criminal activities are only indirectly tracked by monitoring currency transactions involving financial institutions.

Two proposed bills (H.R. 4573 and 3892) are aimed at giving enforcement authorities additional tools to prevent one common means of evading the Bank Secrecy Act--namely, structuring transactions involving more than $10,000 into multiple transactions of a lesser amount. The Board supports efforts to limit such "structuring."

While we generally support the objectives of the bills before the Subcommittee, it is important that their provisions be closely evaluated to ensure that they pass a reasonable cost-benefits test. It is not possible to review in detail all of the provisions of these bills at this

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hearing. However, we do want to stress that in this attempt to strengthen our laws, care should be taken to avoid the collection of more information than is necessary. For such an exercise does not significantly contribute to law enforcement efforts, and only adds to the costs of banking, which are passed on to the consumer.

With regard to specific bills, H.R. 1474 contains a provision that would require federal supervisory agencies to verify compliance with the Bank Secrecy Act in the course of every examination they perform. We currently check for such compliance when making regularly scheduled commercial bank examinations and are implementing numerous steps to strengthen our ability to carry out this function more effectively. We also perform carefully targeted examinations when the need arises. In those instances, in order to make more cost-effective use of our resources, we would like to retain the flexibility to determine the parameters and frequency of such visits. For these reasons, we suggest that the provision not be adopted by the Subcommittee.

H.R. 1474 would also provide that every exemption to the Bank Secrecy Act's requirements be approved by Treasury. Under current regulations, it is the responsibility of the financial institution to determine whether its customers are eligible for such exemptions. We agree with the testimony by Treasury before this Subcommittee that it is not desirable to shift this determination to Treasury and away from the financial institutions that, after all, are in a better position to know the identity and transactional habits of their customers. Such a shift would be unduly burdensome to Treasury and to the financial institutions that would have to supply Treasury with the detailed information needed to make its determinations. Perhaps it would be better to retain current law which allows Treasury, by regulation, to make any such changes it deems necessary. H.R. 3892 would require Treasury to review annually all exemptions to currency reporting requirements granted by a financial institution to its customers. We suspect that this requirement might also prove unduly burdensome to Treasury and financial institutions.

H.R. 1474 would require that all outgoing international wire and other electronic transfers be reported on a Currency or Monetary Instrument Report. While we generally believe that wire and other electronic transfers should be included among the types of transactions regulated by the Bank Secrecy Act, we agree with the testimony given by Treasury before this Subcommittee which stated that this particular reporting requirement should not be imposed by statute. We question whether the burden imposed by the reporting requirement would be offset by the usefulness of the information that the reports would generate. Such information is more effectively acquired through Treasury's existing authority to require specific financial institutions to provide copies to Treasury of all wire transfers taking place within a particular period of time.

H.R. 4280 would require a financial institution to keep special records relating to any cash transaction in excess of $3,000. It is already within Treasury's ability to require this type of record-keeping by regulation as needed, provided it would assist law enforcement efforts in ways that would justify the burden imposed on financial institutions.

H.R. 4280 would establish that the amounts subject to currency transaction reporting requirements be at least $10,000. Currently, Treasury has the authority to vary this amount as necessary to carry out its enforcement responsibilities. We believe that it is useful for Treasury to maintain its ability to respond to changing criminal practices rather than to mandate by statute, as this bill would do, a specific size of transaction to be covered.

H.R. 3892 contains a provision that would include any foreign subsidiary or affiliate of a United States commercial bank in the definition of financial institution for purposes of the Bank Secrecy Act. This would appear to subject these entities to reporting requirements, including filing CTRs for cash or currency transactions of $10,000, regardless of whether they involve U.S. dollars. The Treasury regulations, as we understand them, do not extend the reach of the present reporting requirements beyond our borders. H.R. 3892 would, for the first time, give extraterritorial effect to the reporting requirements, with the likely result of placing U.S. banks, in some instances, in conflict with local law and raising important areas of friction with many host countries who have been particularly sensitive to the extraterritorial application of U.S. law.

FIRICA:

Title I, Supervisory Control Over Depository Institutions

You asked that we revisit certain titles of FIRICA to determine whether they too could be strengthened to keep criminal elements from using financial institutions for illegal gains.

The basic thrust of Title I is to provide the bank regulatory agencies with enhanced tools for combating violations of banking laws and unsafe and unsound activities. Title I authorizes, among other things, the use of civil money penalties for violations of various banking laws (including the Board's Regulations D and O, Section 23A of the Federal Reserve Act, and the Bank Holding Company Act) and provides for enforcement authority against individuals, as opposed to institutions.[1]

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[1] With regard to the authority of the bank regulatory agencies to take enforcement actions directly against individuals, I note that the U.S. Court of Appeals for the (Footnote Continued)

Important though these powers are, we should bear in mind that the Federal Reserve Board is not a criminal law enforcement agency. While our examiners are trained in detecting questionable transactions, any suspected criminal activities are referred to appropriate law enforcement authorities. Therefore, the referral process is critical to successful prosecution under Title I.

The Federal Reserve has been working diligently to improve the criminal referral process. In August 1985, the Federal Reserve distributed to the financial institutions it supervises a uniform criminal referral form. Moreover, the Federal Reserve recently developed and implemented procedures to ensure that criminal referrals involving activities that may affect the safety and soundness of a bank or bank holding company are submitted directly to the Fraud Section of the Department of Justice for high level attention. In addition, procedures have been established to ensure that criminal forms submitted to the Federal Reserve are properly handled. Computer systems also have been

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(Footnote Continued)
Seventh Circuit, in the Larimore v. Comptroller of the Currency case, determined last week that the Comptroller of the Currency could not use its cease and desist authority to seek monetary damages from individuals for violations of law and unsafe or unsound banking practices. This decision was in conflict with other Court of Appeal's decisions, and it may severly limit the ability of the agencies to seek appropriate relief against individuals in matters, for example, involving unjust enrichment. In order to clarify the Federal Reserve's as well as the other bank regulatory agencies' authority in this area, it may be useful for Congress to consider legislation directed at this problem.

developed to track and cross-check the referrals against the activities of the Enforcement Section of the Board's Division of Banking Supervision and Regulation. In this manner, we are better coordinating the actions that must be taken under both civil and criminal law when illegal activity is suspected.

Title VI, Change in Control

Under the Change in Bank Control Act of 1978, bank regulatory agencies have the authority to act on notices involving changes in the control of insured banks and bank holding companies. The Federal Reserve is responsible, in particular, for notices involving state member banks and bank holding companies. Change in Control notices generally must be processed in 60 days. During this period, the reviewing agency considers among other factors, the financial condition and character of the prospective owner or owners. One important objective of this process is to weed-out individuals with criminal backgrounds, either by disapproving the Change in Control or, in effect, by allowing them to disqualify themselves by withdrawing their notice.

Typically, supervisory authorities are familiar with individuals who are seeking to gain control of a financial institution. Change in Control investigations in such cases proceed in a timely fashion. However, there are sometimes cases, such as those involving foreign individuals or individuals who previously have not been involved in banking, where the applicant's background is not known. These cases require the reviewing agency to draw on information from law enforcement agencies and foreign banking agencies. Such information often is not received until well into the 60-day review period, making it necessary to invoke the 30-day extension period allowed under the Change in Bank Control Act in order to make a thorough investigation. We can, however, conceive of situations in which even the 30-day extension period would not be sufficient. Thus, we would favor an amendment to the Change in Bank Control Act that would allow the Board to extend the processing period in those rare situations when it is necessary to collect and evaluate additional information about potential criminal activity.

Title XI Right to Financial Privacy Act

The Right to Financial Privacy Act ("RFPA") was intended to protect bank customers' privacy rights, while enabling federal regulatory and law enforcement agencies to carry out their responsibilities under the law. The RFPA, among other things, prohibits access to the financial records of a customer of a financial institution by government authorities, unless the customer has authorized such disclosure, or the financial records are obtained pursuant to specified agency or law enforcement actions and the customer is given notice of such disclosure. Disclosure also may fall within one of the other limited exceptions to the notice requirement, such as when the information is obtained through the examination process.

The RFPA, however, does not preclude any financial institution from notifying a government authority that it has information which may be relevant to a possible violation of any statute or regulation. In August of 1985, the Board adopted a uniform interagency criminal referral form for the use of the financial institutions under its jurisdiction. Similar forms subsequently were adopted by the other federal regulatory agencies. The form has been carefully structured to elicit information that we were not getting before, perhaps because of perceived RFPA problems. Out of the approximately 400 referrals made by these institutions since that time, only three have lacked necessary information due to perceived RFPA problems and these instances did not involve Bank Secrecy Act violations. We believe that the adoption of these forms by all supervisory agencies will address through administrative action many of the difficulties experienced by the law enforcement agencies in this area.

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International Cooperation

I would now like to turn to the subject of international cooperation. In general, the Federal Reserve maintains extensive contact with foreign bank supervisory authorities in order to discuss broad supervisory issues relating to banking, such as capital adequacy and liquidity. The most visible example of such contact is the Basle Committee on Banking Regulations and Supervisory Practices, which consists of representatives from the central banks and bank supervisory agencies of the major industrial countries. In addition, the Federal Reserve regularly sends a representative to regional meetings of bank supervisors from the Caribbean, Latin America and Asia.

In our view, international steps to assist enforcement efforts are best handled through initiatives such as those undertaken by the Department of Justice to institute mutual legal assistance treaties between the United States and other countries. Such treaties include specific provisions addressing the use of international banking facilities for criminal activities. The Federal Reserve stands ready to assist the Justice Department by making quick referrals of suspected criminal activity to the appropriate authorities and by providing advice on international transactions.

At the same time, the Federal Reserve will continue efforts to heighten the sensitivity of banking authorities abroad to the problems of money laundering

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through the international banking system. In June 1985, this subject was raised informally by the Federal Reserve's representative to the Basle Supervisory Committee. Another occasion for such discussions will be the forthcoming meeting of the Committee which is to be held in Washington at the end of June. A portion of the meeting has already been scheduled to include a discussion of current issues before United States banking authorities, and our representative plans to use this occasion to discuss the possibilities for greater cooperation and communication.

It is important to point out, however, that the ability of bank supervisors to deal with activities such as drug trafficking and money laundering is limited. It is, for example, difficult to monitor international financial transactions given the number and volume of such transactions each day. Moreover, even if such monitoring were feasible, it would be problematic, at best, to hope to draw valid conclusions regarding utlimate origins or destinations of individual transactions.

Further, both foreign and domestic bank supervisors usually are not empowered to investigate criminal activity and, therefore, must refer any evidence of illegal conduct to their respective law enforcement authorities. Foreign bank supervisors may also face serious legal obstacles when disclosure of information on individual customers is involved. It is with regard to these kinds of obstacles that mutual assistance treaties are particularly useful.

Conclusion

In conclusion, I would like to emphasize that the Federal Reserve Board, in conjunction with other federal agencies, has intensified its efforts to address the problem of criminal activity involving financial institutions. The Bank Secrecy Act is but one of the several areas on which we have been focused. Bank fraud, officer and director misconduct, and insider abuse have also received special attention.

We understand the critical importance of promoting improved enforcement and prosecution of bank-related criminal activity, and we look forward to working with the Subcommittee as it reviews and weighs the merits of the various proposals before it.

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STATEMENT

OF

JAMES D. HARMON, JR.

FORMER EXECUTIVE DIRECTOR AND CHIEF COUNSEL
PRESIDENT'S COMMISSION ON ORGANIZED CRIME

BEFORE

THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
SUPERVISION, REGULATION AND INSURANCE

OF

THE

COMMITTEE ON BANKING, FINANCE
AND URBAN AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

H.R. 1367, H.R. 1474, H.R. 1945, H.R. 2785,
H.R. 3892, H.R. 4280 and H.R. 4573

ON

MAY 14, 1986

Mr. Chairman and Members of the Subcommittee:

As the former Executive Director of the President's Commission on Organized Crime, I appreciate the opportunity to testify concerning the various money laundering-related bills now under consideration in this Subcommittee. Since its establishment in July, 1983, the Commission's responsibilities for analyzing organized crime and for defining the uses to which organized crime puts its income have prompted it to devote substantial attention to the problem of money laundering. Although the Departments of Justice and Treasury are thoroughly familiar with the challenges that money laundering has created for law enforcement I want to convey to you some of the concerns that impelled the Commission to devote such attention to money laundering, and to make a number of legislative recommendations in its first interim report, The Cash Connection, that are substantially reflected in the bills now under consideration. In doing so, I also hope to dispel some of the misconceptions, which a few people continue to express concerning the need for various provisions in some of these bills.

At the outset, Mr. Chairman, I would like to take a moment to express appreciation for the sustained attention that this Subcommittee and its members have devoted to the issue of money laundering. Through the Subcommittee's earlier hearings on this subject, and through the introduction of money laundering bills such as H.R. 1474 and H.R. 1367, you and other members of the Subcommittee have underscored the significance of the problem and made clear that new measures must be devised to deal directly with that problem.

The Scope of the Problem

After the issuance of its interim report entitled The Cash Connection: Organized Crime, Financial Institutions and Money Laundering in 1984, the President's Commission continued to analyze organized crime as an economic force. This further analysis has reaffirmed the need for new legislation to make money laundering a Federal criminal offense.

In a study done by Wharton Econometric Forecasting Associates, Inc. of Philadelphia at the request of the President's Commission, Wharton constructed an independent estimate of the income of organized crime using new data sources on the number of persons engaged in organized criminal activities and on the average income of persons involved with criminal organizations. This data was collected through a nationwide survey of law enforcement agencies conducted by the Commission and from a sample of closed IRS tax cases involving members of criminal organizations involved in the

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narcotics trade and members and associates of the La Cosa Nostra engaged in various types of criminal activity.

In the Commission's final report entitled The Impact: Organized Crime in America, issued on April 1, 1986, the Wharton study projected the overall income of organized crime and its adverse economic impact for 1986 as follows:

Income From Organized Crime Activities for 1986
(Billions of Dollars)

	Middle Range Estimate	Lowest Estimate	Highest Estimate
Net Income	$ 43.0	$ 26.8	$ 67.7
Implied Gross Receipts	$ 60.6	$ 37.8	$ 95.5

In addition, the amount of taxes which would have to be paid on the unreported portion (60%) of the lowest estimate ($ 26.8 billion) was calculated to be $ 6 billion. These unpaid taxes combine with higher prices to cause the following:

- A reduction in total output of 17.4 billions 1986 dollars;
- A loss of 394,000 jobs;
- An increase in overall consumer price levels of .3 percent; and
- A reduction in per capita disposable income of $72.54 measured in 1986 dollars.

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Wharton's mid-range net income estimate of $ 43 billion in 1986 for organized crime equals about 1.1 percent of U.S. gross national product making organized crime about the same size, for example, as all U.S. metal producers (iron, steel, aluminum, copper, etc.). Organized crime was estimated to employ at least 281,487 persons as members and associates, with the estimated number of crime related jobs ranging to over 520,000. You will also recall that The Cash Connection contained an estimate that $5 - 15 billion in illegal drug money alone moves into international financial channels each year. It is against this backdrop that the need for money laundering legislation arises, and against which objections to its passage should be balanced.

Money Laundering As A Criminal Offense.

As early as 1970, Congress recognized, in passing the Bank Secrecy Act, that organized crime had substantially increased its use of both domestic and foreign financial institutions in furthering activities to evade investigation by law enforcement agencies. Since then, the Bank Secrecy Act has become increasingly useful to Federal law enforcement agencies in detecting the operations of money launderers and the organized criminal groups who retain their services.

The fact remains, however, that the Bank Secrecy Act does not strike directly at the activities in which money launderers engage: the concealment of the existence, illegal source, or illegal application of income, and the disguising of that income to make it appear legitimate. By its terms, the Bank Secrecy Act imposes civil and criminal penalties only for violations of the Act's reporting and recordkeeping requirements. As a result, a money launderer who complies with the Act's requirements by filing the appropriate forms (as money launderers have frequently done in the past), or who uses other laundering techniques that do not involve financial institutions covered by the Act, may be able to operate for long periods of time with virtual impunity.

Furthermore, although the Bank Secrecy Act remains essential to the detection and deterrence of laundering schemes, recent decisions of the First, Ninth and Eleventh Circuits suggesting that the duty to report rests with the financial institution, not the customer, may have limited severely the use of the Act as a means of prosecuting launderers.

Laundering Techniques and Trends

In the absence of any Federal statute that directly proscribes money laundering, organized criminal groups since 1970

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have become far more sophisticated in devising money laundering schemes and more willing to conceal vast amounts of their profits through the use of such schemes.

Two computerized studies undertaken for the first time by the Internal Revenue Service at the request of the President's Commission point at once to similarities and differences in laundering methods.

The first study examined 775 successfully prosecuted "indirect method of proof" income tax evasion cases against members and associates of La Cosa Nostra ("LCN") and similar prosecutions of narcotics traffickers. The study found that well over 50% of their income went unreported, while each group used similar techniques to gain access to their illegal profit with the following frequency:

Technique	% of LCN Cases	% of Narcotics Cases
Use of Cash	83%	95%
Use of Nominees	74%	65%
Purported Loans	44%	38%
Front Corporations	40%	37%

A second study of the income tax returns of the leadership of La Cosa Nostra showed substantial reported interest income and long term capital gains, especially in the Midwest and South. Taken together both of these studies underscore the layers of insulation present in the laundering process, the essential resort to financial institutions probably at several points along the way with the attendant necessity to facilitate communications between financial institutions and law enforcement, as a means to interrupt the cash flow of organized crime.

In recent years, money laundering specialists have become accustomed to handling criminal proceeds in amounts that almost defy belief. From 1978 to 1982, for example, a money laundering organization headed by Eduardo Orozco - - which the Commission discussed at length in its interim report - - laundered more than $ 150 million on behalf of narcotics traffickers. United States v. Orozco-Prada, 732 F.2d 1076 (2d Cir.), cert. denied, 105 S. Ct. 154, 155 (1984). More recently, a money laundering group headed by Ramon Milian-Rodriguez laundered approximately $ 146 million during a period of only nine months, by physically transporting United States currency from the United States to Panama. At the time of his arrest in 1983, Milian was about to fly his Lear Jet to Panama with a cargo that included more than $ 5.4 million in United States currency. United States v. Milian-Rodriguez, 759 F.2d 1558 (11th Cir. 1985). Still another major money launderer, Beno Ghitis, headed an organization that, during a period of only eight months in 1981, laundered more than $ 242 million on behalf of narcotics traffickers. United States v. Four Million, Two Hundred Fifty-Five Thousand, 37 Crim. L. Rep. 2240 (11th Cir. 1985). Reports such as these, as well as information in the possession of the Commission and law enforcement agencies, indicate that the total amount of money laundered annually from narcotics, illegal gambling, and other illegal activities can be estimated in tens of billions of dollars.

Another significant trend in money laundering is the increasing willingness of some organized criminal groups to tolerate losses of a substantial percentage of their proceeds, where such losses may aid in concealing the illegal source of those proceeds or the conduct of laundering activities. Two significant examples of this trend were disclosed in public testimony at the Commission's hearings on gambling and organized crime.

-- A powerful Cuban organized crime group known as "The Corporation" has amassed several hundred million dollars in assets, primarily from its control of illegal "policy" betting operations in various cities throughout the United States. To aid its members in developing ostensibly legitimate sources of income, The Corporation has devised a scheme involving the legal lottery operated by the

Commonwealth of Puerto Rico. Partly through its control of the lottery's ticket sales in the United States, The Corporation can quickly determine when certain persons have purchased winning tickets of substantial value (for example, a prize of $ 125,000). Representatives of The Corporation then approach the holder of the winning ticket, explain that the prize will be substantially diminished by the payment of Federal income taxes, and offer to purchase the winning ticket (in cash) for an amount in excess of the face value (for example, $ 150,000 for the $ 125,000 ticket). A member of The Corporation can then cash in the ticket and claim his "winnings" as legitimately earned income.

-- In a case recently resulting in convictions in the Eastern District of New York, more than $ 3 million in cash from heroin sales was deposited in the cashier's cages at four Atlantic City casinos. At one of the casinos, the Golden Nugget, one Anthony Castelbuono made an initial deposit of $ 1,187,450 in small bills. According to estimates based on statistics from the Bureau of Engraving and Printing, such a deposit would have a volume of approximately 5.75 cubic feet and would weigh approximately 280 pounds. After losing more than

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> $ 300,000 in chips, and transferring chips among themselves, Castelbuono and a few associates withdrew $ 800,000 in $ 100 bills. Such a withdrawal would have a volume of only 1/3 of a cubic foot and would weigh only 16 pounds. Thereafter, Castelbuono and his associates made additional deposits at the Golden Nugget and continued to gamble there. Eventually, Castelbuono withdrew $ 983,000 in $ 100 bills and left the Golden Nugget. Several days later, one of Castelbuono's associates deposited approximately $ 1 million in an account at the Credit Suisse in Switzerland.

The two cases that I have just described are also significant because they reflect another trend in money laundering: the increasing use of techniques that do not solely require the direct involvement of financial institutions for their success.

Some organized criminal groups have shown greater ingenuity in concealing funds. In one recent case, the Robert Govern marijuana organization, located in Florida, laundered some of its proceeds not only by channeling money through an offshore corporation into a lumber business and an apartment complex, but also conducted numerous off-the-books and under-the-table transactions with the subcontractors who were involved in the construction of that apartment complex. United States v. Zielie, 734 F.2d 1447 (11th Cir. 1984), cert. denied, 105 S. Ct. 957 (1985). In another case, a distributor for the Mario Adamo cocaine organization in Ohio traveled into Canada, where he purchased 2,600 leather coats for cash, and brought the coats back across the border to Columbus, Ohio. Upon his return to Columbus, the distributor and several associates rented a store and a warehouse for thirty days and sold the coats at a price lower than that charged in legitimate retail stores in the Columbus area. The evidence indicated that the distributor undertook this scheme to provide himself with a seemingly legitimate source for the large amounts of money that he was spending while "unemployed." United States v. Adamo, 742 F.2d 927 (6th Cir. 1984), cert. denied, 105 S. Ct. 971 (1985).

Each of these trends - - the increasing magnitude, complexity, and diversity of money laundering schemes and the limits on the Bank Secrecy Act as a prosecutorial device - - - indicates that money laundering has become indispensable for the success and profitability of large-scale organized criminal ventures. If law enforcement authorities can strike directly at the conduits that enable organized crime to conceal its investments or disbursements of funds, they may be able to discourage organized criminal groups from abusing legitimate financial and commercial institutions, and ultimately to cause irreparable damage to the

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operations of organized crime.

The Bifurcated Standard of Interest

In drafting its proposed statute to make money laundering a Federal crime, however, the Commission recognized that while all participants in a money laundering scheme might be deemed equally responsible for its success, some participants will be more knowledgeable than others about the illegal activities which generate the funds to be laundered. Those responsible for planning, organizing, and overseeing the scheme, for example, are more likely to be privy to information concerning the scope and extent of their clients' illegal activities. Such information would clearly indicate to any money launderer that his intent to carry out the laundering scheme successfully also constitutes intent to further or facilitate the conduct of the underlying illegal activities. In contrast, those responsible for more ministerial duties (such as the picking up or delivery of the funds being laundered) may not know all the details of their clients' activities, but are highly likely to be exposed to information that gives them actual knowledge (or reason to know) the true nature or source of the funds they are laundering. For these reasons, the Commission decided to adopt a bifurcated standard of intent that would encompass both the directors and the minions of a money laundering organization. At least one

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state (Arizona) has recently enacted a money laundering statute that employs a bifurcated standard of intent, and that specifically uses the standard of knowledge or "reason to know" for "second-degree" money laundering. (See Appendiz A.) Moreover, two of the bills pending in the Subcommittee (H.R. 1367 and H.R. 1945) also propose the use of the bifurcated standard of intent.

H.R. 2785 also employs a bifurcated standard of intent, although it substitutes the concept of recklessness for the concept of reason to know. It should be noted, however, that the underlying objective of the Commission's proposal is substantially similar to that of H.R. 2785; despite the difference in terminology, both seek to ensure that a money launderer may be held to account even if he did not have actual knowledge that the funds he was laundering were the proceeds of, or were directly or indirectly derived from, an unlawful activity.

The Commission's approach to this problem was intended solely to reaffirm the longstanding rule that, where knowledge of the existence of a particular fact is an element of an offense, the government can meet its burden of proof by proving beyond a reasonable doubt that the defendant was aware of a high probability of the existence of that fact, unless he actually believes that fact does not exist. See generally United States v. Jewell, 532 F.2d 697, 700-01 (9th Cir) (en banc), cert. denied, 426 U.S.

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951 (1976). This rule, as stated in Section 2.02(7) of the Model Penal Code, is intended to deal with the situation known as "wilful blindness" or "conscious avoidance of knowledge," in which "a party has his suspicion aroused but then deliberately omits to make further enquiries, because he wishes to remain in ignorance . . ." G. Williams, Criminal Law: The General Part Sec. 2.02(7) comment 9 at 129-30 (Tentative Draft No. 4 1955). In applying this rule, courts will look to all the circumstances pertinent to the person's intent. See, e.g., United States v. McAllister, 747 F.2d 1273, 1275 (9th Dir. 1984); United States v. Jacobs, 475 F.2d 270, 287-88 & n.37 (2d Cir. 1973).

Similarly, the recklessness standard in H.R. 2785 would require courts to look to all the circumstances of the transaction (including, but not limited to, the amount and type of funds or monetary instruments and the nature of the transaction) to determine whether a person is aware of a substantial risk that such funds or monetary instruments represent the procees of, or are derived directly or indirectly from the proceeds of, an unlawful activity, but disregards the risk. This standard of reckless disregard, of course, is not identical to the standard of actual knowledge or "wilful blindness." See McAllister, 747 F.2d at 1275. Its principal focus is the standard of care that a reasonable person would exercise in such a situation. Although the definition of this standard uses certain words and phrases found in the Model Penal Code's definitions of recklessness and negligence, see Model Penal Code Sec. 2.02(2) (c), (d), it clearly contemplates that courts will conduct a subjective inquiry into the person's appreciation of the risks involved in his conduct. See P. Low, J. Jeffries, & R. Bonnie, Criminal Law 232 (1982).

The reasons for specifying that "all the circumstances of the transaction" include the amount and type of funds or monetary instruments, as well as the nature of the transaction, are clear. In many instances involving the laundering of narcotics proceeds, for example, even the most elementary details of the transaction reflect the effort to launder: (1) the predominant use of small-denomination bills - - ones, fives, tens, twenties, and, sometimes, fifties; (2) a substantial volume of bills used in the course of a single transaction; (3) the appearance of counterfeit bills, which are often included in payments for narcotics, in large-volume deposits of bills; (4) unusual methods of transporting funds or monetary instruments for a transaction (such as cardboard boxes, suitcases, duffel bags, flight bags, gym bags, and even garbage bags); and (5) unusual behavior by persons involved in the transaction (such as the failure or refusal of persons initiating a transaction to identify themselves or to take receipts for any funds deposited in a financial institution).

One other issue concerning the standard of intent has been raised in the past by the National Council of Savings Institutions. The Council believed a bank teller who is innocent of any involvement in a money laundering operation, but who may have actual knowledge that monetary instruments offered for deposit are derived from an illegal source, would presumably be violating the proposed section 1956 if the teller were to complete the transaction with the intention of notifying a supervisor or law enforcement agency after the completion of the transaction.

Although it is highly unlikely that a United States Attorney or an Organized Crime Strike Force Chief would find substantial merit in prosecuting a teller in those circumstances, the matter warrants some clarification. While it seems clear that no reputable financial institution would want to hold itself out as a haven for criminal proceeds, the fact remains that Federal law enforcement agencies may want financial institutions, on occasion, to begin or to continue accepting deposits from suspected money launderers. By authorizing or permitting what might be termed "controlled deliveries" of criminal proceeds to financial institutions, Federal law enforcement agencies can better determine the scope and extent of a money laundering operation and amass sufficient evidence to indict and convict the leaders of such an operation and, just as important, to seize the laundered funds.

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For these reasons, it may be appropriate to clarify in the legislative history that an officer or employee of a financial institution who knows or suspects that monetary instruments being offered for deposit have an illegal source will not be deemed to have the resquisite intent under section 1956, if that officer or employee notifies a Federal law enforcement agency of that knowledge or suspicion either before the transaction is completed or immediately thereafter (i.e., no later than the end of that day).

The Right to Financial Privacy Act

I would now like to turn to a second principal topic: the changes that H.R. 1367 and H.R. 2785 propose in the Right to Financial Privacy Act. In the past, a representative of the American Bankers Association has been quoted in The American Banker as saying that the provisions of the Administration's money laundering bill "would virtually repeal all the protections established by Congress in 1978 when it approved the . . . Act." That statement, in my view, is wholly without foundation: nothing in either the text or the accompanying explanation of the proposed changes contemplates either a total or a partial repeal of the Right to Financial Privacy Act. A careful examination of these changes will demonstrate that they are carefully crafted to deal with certain specific problems that came to the Commission's attention in the course of preparing its interim report on money laundering.

The Commission has never advocated the total or partial repeal of the RFPA, and fully appreciates that the RFPA "seeks to strike a balance between customers' right of privacy and the need of law enforcement agencies to obtain financial records pursuant to legitimate investigations." H.R. Rep. No. 1383, 95th Cong., 2d Sess. 33, reprinted in 1978 U.S. Code Cong. & Ad. News 9273, 9305. However, the Commission's continuing examination of money laundering has revealed considerable evidence that certain provisions of the RFPA have unintentionally created difficulties for both financial institutions and law enforcement agencies. Both the Commission's legislative proposal and bills before this Subcommittee seek to resolve these difficulties by means of limited amendments to the RFPA that are entirely consistent with the Act's underlying intent.

In general, the Act prohibits a Federal Government entity from obtaining access to, copies of, or information contained in the financial records of any customer from a financial institution, unless the customer grants his or her consent or the Government authority obtains an administrative subpoena or summons, a search warrant, a judicial subpoena, or a formal written request for disclosure of such financial records. 12 U.S.C. Sec. 3402. (Grand jury subpoenas and court orders

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issued in connection with grand jurty proceedings have a special exemption from most provisions of the Act. *Id*. Sec. 3413(i).) A number of provisions in the Act appear to be based on the assumption that a Government authority is likely to seek financial records from a financial institution only after that authority has already opened a formal investigation or initiated formal proceedings of some type. *See* U.S.C. Sec. 3401(7), 3405(1), 3406(a), 3407(1), 3408(3), 3409(a), 3412(a), 3420.

One issue which the Act does not clearly address, however, is the extent to which a financial institution that suspects one of its customers of money laundering or other illegal activities involving that institution may notify Federal law enforcement authorities of that suspicion, and thereby prompt the opening of a formal investigation. Section 1103(c) of the Act states only that nothing the Act "shall preclude any financial institution, or any officer, employee, or agent of a financial institution, from notifying a Government authority *that such institution*, or officer, employee, or agent *has information which may be relevant to a possible violation of any statute or regulation*." 12 U.S.C. Sec. 3403(c) (emphasis supplied). A strict reading of this provision would permit the financial institution to notify the Government authority only that it "has information which may be relevant," but not to disclose any of the information or the reasons that the financial institution considers such information to be relevant.

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In practice, the Commission found that financial institutions regularly asserted the RFPA as a bar to the production of specific information sought in furtherance of the Commission's investigation of money laundering. This response by financial institutions was no different than that which I had experienced in more than ten years as a local and Federal prosecutor.

Because sections 1117 and 1118 of the Act authorize customers to seek damages and injunctive relief against a financial institution or Government authority that obtains or discloses financial information in violation of the Act, a number of financial institutions apparently have adopted the strict reading of section 1103(c). Although there do not appear to be any reported Federal decisions that would support this reading of the statute, at least one state decision has held that a bank which had provided local police with information concerning one of its customers had wrongfully disclosed information concerning the customer's account without obtaining the express or implied consent of the customer to that disclosure. See Suburban Trust Co. v. Waller, 44 Md. App. 335, 408 A.2d 758 (Md. Ct. Spec. App. 1979).

To clarify the issue in a manner that would permit financial institutions to notify law enforcement authorities of ongoing money laundering activities, the Commission proposed that section 1103(c) of the Act be amended to authorize financial institutions to disclose sufficient information concerning a possible violation of law, so that a law enforcement agency could determine whether to open a formal investigation on the basis of that information. In addition, to allay financial institutions' concerns about possible civil liability for such disclosures, the Commission proposed that section 1117(c) of the Act be amended to create a good-faith exception as an absolute defense to a civil action brought by a customer. Both of these proposals are substantially reflected in section 401 of H.R. 1367 and section 3(a)-(d) of H.R. 2785.

The object of these proposals, as I have explained, is not to compel financial institutions to disclose financial records indiscriminately, but simply to enable - - not to compel - - financial institutions to notify law enforcement authorities of possible illegal activity without incurring civil liability under the Right to Financial Privacy Act.

The Preemption Provision

To date, there has been no definitive judicial resolution of whether the Supremacy Clause of the United States Constitution would require provisions of state law to give way to any provisions of the Right to Financial Privacy Act with which the state law is in conflict. Compare United States v. First Bank, 737 F.2d 269 (2d Cir. 1984) (holding that under Supremacy Clause, notice provisions of Connecticut Financial Privacy Act preempted by provisions of Internal Revenue Code governing IRS summons), and In re Grand Jury Subpoena (Connecticut Savings Bank), 481 F. Supp. 833 (D. Conn. 1979) (holding that under Supremacy Clause, Connecticut statute imposing notice and challenge procedure must give way to Federal grand jury subpoena), with In re The Grand Jury Subpoena East National Bank of Denver, 517 F. Supp. 1061 (D. Colo. 1981) (rejecting Supremacy Clause argument challenging judicially-created state expectation of privacy in bank records). To reconcile the concerns of Federal law enforcement authorities and financial institutions, the Commission proposed that the Right to Financial Privacy Act be amended to include an express provision preempting any state law or decision that is more restrictive than the Act in regulating disclosures of financial records under the Act. That proposal is substantially reflected in section 401(a) of H.R. 1367 and section 3(g) of H.R. 2785.

The preemption provision in H.R. 1367 and H.R. 2785 does not preempt all state laws or judicial decisions dealing with financial privacy. Its object is simply to ensure that state financial privacy laws that are more restrictive than the Right to Financial Privacy Act do not create an impediment to the effective investigation of Federal crimes.

Although there are additional provisions concerning the Right to Financial Privacy Act that I can discuss, I think that it might be appropriate to conclude my remarks at this point. I will be happy to answer any questions that the Subcommittee members may have.

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APPENDIX A

ARIZONA MONEY LAUNDERING STATUTE

13-2317. Money laundering; classifications; definitions

A. A person who acquires or maintains an interest in, transfers, transports, receives or conceals the existence or nature of racketeering proceeds knowing or having reason to know that they are the proceeds of an offense is guilty of money laundering in the second degree.

B. A person who knowingly initiates, organizes, plans, finances, directs, manages, supervises or is in the business of money laundering is guilty of money laundering in the first degree.

C. Money laundering in the second degree is a Class 3 felony. Money laundering in the first degree is a Class 2 felony.

D. In this section, "acquire" and "proceeds" have the same meaning as prescribed in section 13-2314.

AMERICAN BAR ASSOCIATION
[illegible]TON, D.C. 20036 • (202) 331-[illegible]

STATEMENT OF

SAMUEL J. BUFFONE

MEMBER,
WHITE COLLAR CRIME COMMITTEE
CRIMINAL JUSTICE SECTION

ON BEHALF OF
THE
AMERICAN BAR ASSOCIATION

BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,
REGULATION AND INSURANCE
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING
MONEY LAUNDERING LEGISLATION

MAY 14, 1986

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My name is Samuel J. Buffone. I am a practicing criminal defense attorney and offer this testimony on behalf of the American Bar Association.

In December of 1984 the White Collar Crime Committee of the ABA set up a subcommittee to study the problem of money laundering and proposed legislation designed to combat it. The Committee consists of 58 members of the ABA's Section of Criminal Justice, including defense lawyers, prosecutors, law professors and judges, at both state and federal levels. The Subcommittee was chaired by Bernard Bailor, a partner in the Washington, D.C. firm of Caplin & Drysdale.

Following an extensive study a report was prepared and adopted by the Council of the Criminal Justice Section on December 7, 1985. The report and recommendations included with my testimony were presented to the ABA's House of Delegates in February 1986. The House of Delegates adopted the recommendations. The report of the Criminal Justice Section was not adopted by the House of Delegates but is provided to the Committee as background. I have also included with my testimony comments of the ABA section on Corporation Banking and Business Law on portions of the recommendations and report.

The American Bar Association recognizes the pervasive nature of money laundering activities and the importance of combatting them. Our recommendations support the enactment of federal legislation which will assist federal law enforcement agencies in combatting money laundering. While we believe that it is important to provide effective tools to combat money laundering, our review of proposed legislation has led us to the conclusion that the proposals go much farther than is necessary to provide an effective means to combat this problem. The breadth of many provisions of the proposed legislation create significant problems and do not in our view provide the most effective means for combatting money laundering activities.

The ABA believes that the most effective way to combat money laundering is to enact legislation that facilitates its detection. The available studies including the interim report of the President's Commission on Organized Crime, entitled The Cash Connection: Organized Crime Financial Institutions and Money Laundering, reveals that detection of money laundering is a far more significant problem than prosecuting the responsible parties after it is discovered. This follows from the inherently clandestine nature of money laundering. We recommend that legislation be geared to facilitating detection of such transactions and be specifically aimed at the following steps which appear in virtually every major money laundering case:

1. The use of foreign transactions
2. Failure to comply with the Bank Secrecy Act Reporting Requirements
3. Use of multiple transactions to avoid reporting
4. Conducting transactions with individuals in institutions not subject to the Bank Secrecy Act's reporting requirements

We recommend the following specific steps be taken:

First, the Bank Secrecy Act should be amended to provide for faster notification to law enforcement agencies of possible

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money laundering transactions. Changes should be instituted in agency procedures to provide for prompt investigation of suspect transactions. Our review indicates that while the Bank Secrecy Act is a potentially powerful weapon in the fight against money laundering, delays in the reporting and processing of information often render it ineffective. The permissible 15 day delay in filing CTR's and the administrative mechanism for processing the information within the Treasury Department leads to stale information in the hands of law enforcement authorities.

We recommend that consideration be given to requiring CTR's within one business day of the transaction. A possible way of providing such prompt reporting is to have bank customers complete and sign a postcard form at the time of the transaction, with their identification verified by the teller. Additionally, it may be possible to have financial institutions inform law enforcement agencies of certain types of suspect transactions telephonically within one business day. It should be noted that the comments of the Section of Corporation, Banking and Business Law on these two proposals indicate that their implementation may cause some difficulty for the banking industry.

We also recommend that special procedures be used to limit the effectiveness of cashier's checks and treasurer's checks as money laundering vehicles. We believe that consideration should be given to implementing procedures which would reduce the reporting requirement for such instruments to $2,000 when purchased by non-account holders and requiring that more than

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one business day be involved to complete any transaction. This would greatly reduce the attractiveness of such instruments to money launderers.

Our second recommendation is that the number of personnel available to the Department of Treasury and Attorney General to investigate compliance with the Bank Secrecy Act and to investigate potential money laundering transactions be increased. Figures generated by the interim report of the President's Commission on Organized Crime indicate that the Bank Secrecy Act has been grossly under-utilized. We strongly support increases in investigative and administrative personnel in order to render the Bank Secrecy Act a more potent weapon. It is our view that effective investigation of money laundering activities is a time consuming process. We believe that increasing the number of personnel assigned to money laundering investigations is the single most effective step that can be taken to combat money laundering.

Our third recommendation is that the administrative regulations and the Bank Secrecy Act itself should be amended to require additional reporting of foreign transactions, including certain transactions not involving currency or monetary instruments. Most large sophisticated money laundering transactions use a foreign account or foreign transactions as part of the laundering scheme. The typical transaction involves the expatriation of funds in the form of cash and their repatriation in a form that is less detectible. A reporting requirement, similar to that imposed on domestic currency and monetary instrument transactions relating to

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letters of credit and similar financial instruments would provide an effective means for tracking such transactions.

The section recommends that wire transfers of funds from foreign countries and the receipt of letters of credit or similar guarantees of loan repayment be reported. An exemption would, of course, need to be included for routine business transactions. The section on Corporation Banking and Business Law has commented on this section of our report indicating that the strain on major financial institutions would be considerable from such reporting. Additionally, we encourage continued efforts to obtain agreements with foreign governments as the most effective ways of combatting this prong of the money laundering process.

In addition to these affirmative recommendations, we appreciate the opportunity to offer to this Committee our views on current legislative proposals. Each of the legislative proposals includes the creation of some new money laundering offense. We recommend the enactment of a narrowly drafted statute to combat money laundering. Our strongest recommendation is that any new offense include a *mens rea* element that prohibits only the intentional and knowing use of financial transactions designed to conceal criminally derived property. The inclusion of the traditional *mens rea* standard of intentionally and knowingly minimizes the risk of conviction of innocent persons.

We support the provisions of H.R. 1474 introduced by Congressman William Hughes which require the traditional criminal *mens rea* standard of "knowingly." We object to any offense which is based on a "reason to know" or "reckless disregard" standard as overly expansive. The use of the reckless disregard standard in H.R. 2785. H.R. 2786 and S. 1335 which are each similar to the standard proposed by the President's Commission on Organized Crime creates too far-reaching a criminal offense.

We additionally oppose the provisions of H.R. 2785, and H.R. 2786 that define unlawful activity as including any state or federal felony. The extremely broad definition of unlawful activity will greatly expand the authority of federal agencies to investigate and prosecute what have formerly been state law offenses. Virtually any crime with an economic motive would be subject to federal prosecution. It goes without saying that any such economic crime would result in some disposition of the proceeds, therefore creating a money laundering offense under the proposed legislation. Additionally the amendments of the Comprehensive Crime Control Act of 1984 would provide expansive wire-tap authority for investigation of any such crime. The ABA believes that this is neither necessary or desirable.

We believe that there is a need to strengthen, simplify and streamline statutes relating to money laundering. We question, however, whether any compelling need has been demonstrated for the passage of legislation as sweeping as that proposed. It is our belief that the principle problem is detection and not prosecution of money laundering activities. We have detailed in our report a list of available statutory bases for prosecuting money laundering activities. As the recent Court of Appeals decisions in United States v. Anzalone, 766 F.2d 676

(1st Cir. 1985) and United States v. Varbel, 780 F.2d 758 (9th Cir. 1985) indicate, many of the problems in prosecuting money laundering could be eliminated by redrafting the Treasury Department regulations implementing the Bank Secrecy Act. The problem of structured transactions could be dealt with in this way without the need for sweeping legislation that would encompass far more than the evil of structured transactions.

We oppose the creation of any amendment to Title 18 §2 which would create a new offense of knowingly facilitating the commission of an offense by another. There has been no demonstrated need for such a sweeping revision of the basis of federal criminal responsibility. Both the general conspiracy statute, 18 U.S.C. §371, and the existing aiding and abetting statute, 18 U.S.C. §2, are sufficient means of combatting money laundering. Our specific objection is that the new offense departs from the well-established concepts of both legislation and case law which have recognized that knowledge of the commission of a crime, coupled with association of a criminal, is not a sufficient basis for a criminal conviction.

We oppose the proposed amendment to Rule 17(c) of the Federal Rules of Criminal Procedure which would permit direction to a subpoenaed party not to disclose the existence of the subpoena to any other party. While our objection to this proposal is broader, we are specifically opposed to a prohibition on a witness contacting an attorney regarding the subpoena.

We are opposed to Section 8 of the Administration's bill which would create a new offense of receiving the proceeds of a

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crime. We object to the mens rea standard included in the proposed legislation of "knowing or believing the same" to be property obtained in violation of law. This statute would allow conviction on the impossibly subjective test of the belief of the accused. We are also concerned that this provision of the proposed statute would infringe upon the Sixth Amendment right to counsel. Under the proposed legislation it is unlikely that an attorney could accept a fee from a client who had possibly engaged in criminal activity. This is especially true given the belief standard of the proposed legislation.

We object to the expansion of in personam forfeiture contained in H.R. 2785, H.R. 2786 and S. 1335. We believe that the proposed forfeiture legislation will unduly infringe the Sixth Amendment right to counsel and represents an unwarranted increase in criminal penalties.

The forfeiture provisions, as currently drafted, are overly broad and contain many ambiguities which will require significant judicial resources to clear up. Specifically, the proposed forfeiture provisions fail to establish the link between the defendant, the criminal activity and the proceeds to be forfeited. There is no nexus between the defendant and these other elements.

We similarly object to the relation back and substitute asset provisions. The relation back doctrine makes little sense given the difficulty of defining the act which gives rise to the forfeiture. The substitute asset provision comes dangerously close to the long established bar on forfeiture of estates. In addition, the substitute asset provision will place the defendant in the incongruous position of being trustee or fiduciary to the government's unsecured claim from the moment of the criminal act.

It has been a pleasure to be able to appear today and explain the American Bar Association's position on money laundering legislation. The ABA is willing to assist the Subcommittee in any way it can to refine this legislation and develop a workable solution to the money laundering problem. I will be glad to answer any questions.

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Approved as American Bar Association Policy
by the ABA House of Delegates - February 1986

The House acts only on the recommendation.
The report is provided for background.

AMERICAN BAR ASSOCIATION
SECTION OF CRIMINAL JUSTICE
REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

BE IT RESOLVED, That the American Bar Association supports enactment of federal legislation which will assist federal law enforcement agencies in combatting money laundering through the following:

1. Create a new federal criminal offense of "money laundering" which proscribes intentionally and knowingly engaging in financial transactions designed to conceal criminally derived property.

2. Amend the Bank Secrecy Act to provide for faster notification to law enforcement agencies of possible money laundering transactions.

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3. Increase substantially the number of personnel available to the Secretary of the Treasury and the Attorney General to investigate potential money laundering transactions.

4. Amend the Bank Secrecy Act to require additional reporting of foreign transactions including transactions not involving currency or monetary instruments which are commonly used to conceal money laundering transactions.

BE IT FURTHER RESOLVED, That the American Bar Association opposes the enactment of proposed legislation dealing with money laundering which would:

1. Create a new crime of money laundering as contained in the Administration's legislation, H.R. 2785, H.R. 2786, and S. 1335, and also in H.R. 1367, H.R. 1945, and S. 572 (99th Congress), or any other legislation which does not contain the requirement that the offense be intentionally and knowingly committed.

2. Create a new crime of Facilitating an Offense as contained in the Administration's legislation, H.R. 2785, H.R. 2786, and S. 1335 (99th Congress).

3. Amend Rule 17(c), Federal Rules of Criminal Procedure, contained in the Administration's legislation, H.R. 2785, H.R. 2786, and S. 1335 (99th Congress), which would authorize a court to direct the recipient of a grand jury subpoena not to notify anyone of the existence of the subpoena.

4. Amend the Right to Financial Privacy Act as contained in the Administration's legislation, H.R. 2785, H.R. 2786, and S. 1335 (99th Congress), to delete the requirement that records obtained from a financial institution pursuant to grand jury subpoena must be returned and actually presented to the grand jury.

5. Create a new crime of Receiving the Proceeds of a Crime as contained in the Administration's legislation, H.R. 2785, H.R. 2786, and S. 1335 (99th Congress).

6. Expand the scope of federal forfeiture law as contained in the Administration's legislation, H.R. 2785, H.R. 2786, and S. 1335 (99th Congress).

REPORT

I. INTRODUCTION

This report and the accompanying resolution was considered by the Council of the Criminal Justice Section at its fall meeting on December 7, 1985. The resolution was developed by the Section's White Collar Crime Committee. This report was prepared by a Subcommittee created in December of 1984 by Marvin Pickholz, Chairman of the White Collar Crime Committee of the Criminal Justice Section, to study the problem of money laundering and to evaluate the various proposals and legislative recommendations on methods of dealing with the money laundering problem.

Money laundering is the process used to conceal the source of illegally obtained funds. In some cases, it is also used to facilitate other crimes such as tax evasion, smuggling and bribery. There is increasing recognition that an effective way to investigate and ultimately prosecute certain types of criminal activity is to focus the investigation on the profits arising from the criminal activity. By investigating the use of illicitly earned profits, it is often possible to identify parties involved in criminal activity who, because of their role in the activity or position in the criminal organization, would otherwise escape detection. This approach has proven to be highly effective in investigating narcotics and organized crime organizations. High level individuals in these types of criminal organizations rarely get directly involved in the substantive criminal activity. Thus, they can often only be linked to the criminal activity through the substantial profit earned from it.

Recognition of the significant role money laundering plays in the operation of criminal organizations has led to a number of proposals designed to increase the effectiveness of federal law enforcement agencies in dealing with money laundering. Legislation to deal with money laundering has been recommended by the President's Commission on Organized Crime, by the Administration and by various members of both the House and the Senate. The Section has reviewed and analyzed the following bills introduced in the House and Senate:

(1) S. 1335 - The Administration Bill introduced in the Senate on June 20, 1985, by Senator Thurmond.

(2) H.R. 2785 and H.R. 2786 - The Administration Bill introduced in the House of Representatives on June 18, 1985, by Representative St. Germain.

(3) H.R. 1367 - A bill introduced in the House of Representatives on February 28, 1985, by Representative McCollum which tracks the recommendations of the President's Commission on Organized Crime.

(4) H.R. 1474 - A bill introduced in the House of Representatives on March 7, 1985, by Representative Hughes.

(5) H.R. 1945 - A bill introduced in the House of Representatives on April 3, 1985, by Representative Hubbard.

(6) S. 572 - A bill introduced in the Senate on March 5, 1985, by Senator D'Amato.

(7) S. 571 - A bill introduced in the Senate on March 5, 1985, by Senator D'Amato.

In addition to reviewing the preceding legislation, the Section has also considered other approaches in dealing with the money laundering problem.

II. RECOMMENDATIONS OF THE SECTION

The Section believes that the most effective way to combat money laundering is to enact legislation that facilitates its detection. As discussed in Section III of this Report, the Section believes that most of the proposed legislative solutions are not an effective response to the money laundering problem and recommends against their adoption.

Analysis of the Interim Report to the President and the Attorney General, THE CASH CONNECTION: Organized Crime, Financial Institutions, and Money Laundering, President's Commission on Organized Crime (October 1984) [hereinafter, the "Interim Report"] reveals that detection of money laundering is a far more significant problem than prosecuting the responsible parties after it is discovered. The President's Commission on Organized Crime has also noted this. See, Interim Report, p. 26. Similar conclusions can be drawn from an analysis of other Congressional hearings and reports dealing with money laundering. Each of the twenty examples of money laundering cited in the Interim Report could be and was prosecuted under existing legislation. The difficulty encountered in commencing the prosecution was in detecting the crime and the associated money laundering in the first instance. This is understandable since money laundering by its very nature is clandestine.

Based upon our review of the Congressional and other reports dealing with money laundering, in virtually all cases, money laundering involves at least one of the four following steps:

1. The use of a foreign transaction or a foreign bank account.
2. Failure to comply with the Bank Secrecry Act reporting requirements.
3. The use of a series of transactions instead of a single transaction to conceal a transaction reportable under the Bank Secrecy Act.
4. Conducting large transactions with individuals and institutions who are not subject to the Bank Secrecy Act reporting requirements.

The Section believes that unless specific steps are taken to deal with these common money laundering devices, effective control over money laundering cannot be achieved.

Analysis of the examples of money laundering cited by the President's Commission on Organized Crime in the Interim Report reveals that the following methods were used to launder funds:

Method of Laundering	No. of Cases	Percent
Use of foreign transaction or foreign bank account	12	60
Use of Casino	1	5
Use of "Front" Business	1	5
Failure to comply with Bank Secrecy Act Reporting Requirements	6	30
Totals	20	100

Other reports on money laundering reveal a similar pattern. According to a report entitled: Drug Money Laundering, S. Hg. 99-8, Committee on Banking, Housing, and Urban Affairs, U.S. Senate (January 28, 1985), another common method of money laundering used particularly by street level drug dealers is the purchase of cashier's checks in denominations of less than $10,000 (the minimum amount requiring the filing of a CMIR). The cashier's checks are sometimes made payable to a fictitious payee and deposited into a foreign bank account.

The Section recommends the following specific steps be taken to increase the ability of federal law enforcement agencies to detect money laundering and prosecute the underlying violations:

1. Amend the Bank Secrecy Act to provide for faster notification to law enforcement agencies of possible money laundering transactions and institute changes in agency procedures to provide for prompt investigation of suspect transactions.

2. Substantially increase the number of personnel available to the Secretary of the Treasury and the Attorney General to investigate compliance with the reporting requirements of the Bank Secrecy Act and to investigate potential money laundering transactions.

3. The Bank Secrecy Act and the administrative regulations adopted pursuant thereto should be amended to require additional reporting of foreign transactions including transactions not involving currency or monetary instruments which are commonly used to conceal money laundering transactions.

COMMENTARY ON RECOMMENDATIONS

1. Amend the Bank Secrecy Act to provide for faster notification to law enforcement agencies of possible money laundering transactions and institute changes in agency procedures to provide for prompt investigation of suspect transactions.

Although the Bank Secrecy Act provides for the reporting of potential money laundering transactions, the effectiveness of this tool has been diminished by the inexcusable length of time it takes for information on reported transactions to reach law enforcement agencies. In some cases, more than two months elapse between the date of the transaction and the reporting of the transaction to a law enforcement agency. As a result, successful investigations into suspected money laundering are frequently impossible because of the staleness of the information. This is particularly true in those transactions which involve fictitious names.

The President's Commission on Organized Crime has described the process by which reported information is made available to law enforcement agencies as follows:

> When financial institutions file CTRs in accordance with current Treasury Department regulations and procedures, it may take the Treasury Department six or eight weeks or longer for the data on CTRs to be processed and made ready for analysis at the Treasury Financial Law Enforcement Center (TFLEC). Treasury Department regulations currently permit financial institutions to file a CTR as late as 15 days after the day on which the transaction occurred. Thereafter, the IRS must process all CTR data at its facility in Ogden, Utah, and transport the input data to a U.S. Customs Service office in San Diego, California, before reporting the data to TFLEC at headquarters. TFLEC analysts and Treasury Department officials may then require additional time for review and analysis of the CTR data. Interim Report, p. 25.

These procedures clearly diminish the effectiveness of the reporting provisions of the Bank Secrecy Act. The President's Commission on Organized Crime has recommended that, to reduce the time required to process and analyze CTR data, the Secretary of the Treasury should consolidate the processing of such data in a single location. Interim Report, p. 57. The President's Commission on Organized Crime has also recommended:

> To expedite the process by which financial institutions can inform law enforcement agencies of specific violations of the reporting requirements under the Bank Secrecy Act, the Secretary of the Treasury and financial institutions should coordinate the implementation of a procedure whereby a financial notation on a CTR or CMIR, as appropriate, to the IRS or Customs officer responsible for inputting such data, and telephone a particular office (such as the IRS compliance officer) to alert it to the contents of the CTR or CMIR. Interim Report, p. 57.

While the President's Commission on Organized Crime's recommendation is phrased to suggest that only violations of the Bank Secrecy Act reporting requirements are to be reported, we believe that what is intended is more prompt reporting of all reportable transactions. The Section concurs in these recommendations. Steps that could be taken to improve the reporting of potential money laundering transactions might include requiring financial institutions to mail reports required by the Bank Secrecy Act and regulations within one business day of the transaction. This could be accomplished by having the bank customer complete and sign a postcard form at the time of the transaction with the identification information verified by the teller. The form could be made subject to the false statement provisions of 18 U.S.C. § 1001 thereby providing a basis for prosecuting a false filing.

Financial institutions might also be required to inform law enforcement agencies of certain types of suspicious transactions within one business day by telephone. The types of transactions required to be reported by telephone could be clearly established by administrative regulation. In this manner, unusual or suspicious transactions, such as large, repeated deposits, could promptly be brought to the attention of responsible authorities. It would be a relatively simple matter to set up an 800 number whereby the contents of the Bank Secrecy Act report could simply be read to a law enforcement official who could make a preliminary evaluation of the information and, if warranted, refer it to the appropriate investigative agency for immediate investigation.

Special procedures could be implemented for dealing with treasurer's checks and cashier's checks purchased by other than established account holders of the financial institution. The Section feels that special treatment is required for treasurer's checks and cashier's checks purchased by non-accountholders because this is one of the most commonly used devices to launder street drug money. Virtually all reports on money laundering cite this method as one of the most commonly used. The process by which money is laundered through the purchase of cashier's and treasurer's checks is simple. An individual, referred to in the drug community as a "smurf," is assigned the task of taking large amounts of currency obtained in street drug transactions to numerous banks to purchase cashier's checks. At each institution, a cashier's check is purchased in an amount less than the current reporting requirement. The cashier's checks, which are the virtual equivalent of currency, are then deposited at another institution without any reporting requirement. In many cases, they are deposited in an offshore financial institution.

The Section believes consideration should be given to implementing procedures for cashier's and treasurer's checks such as reducing the reporting requirement for these transactions to $2000 when purchased by non-accountholders and requiring more than one business day to complete the transaction. By reducing the threshold reporting requirement on these instruments to $2,000, these transactions will be much more difficult to use for money laundering purposes. Most legitimate purchases of cashier's checks by non-accountholders will fall below the $2,000 reporting requirement. By requiring the transaction to take more than one business day to complete, the potential money launderer will be required to make two trips to the financial institution. These procedures coupled with prompt notification will substantially deter money laundering transactions of this type and increase the likelihood of detection and apprehension.

2. Substantially increase the number of personnel available to the Secretary of the Treasury and the Attorney General to investigate compliance with the reporting requirements of the Bank Secrecy Act and to investigate potential money laundering transactions.

Despite the well recognized importance of money laundering investigations, it is clear that insufficient resources are being devoted to them. The Interim Report of the President's Commission on Organized Crime paints an abysmal picture of enforcement efforts in this area. The Bank Secrecy Act, as amended by the Currency and Foreign Transactions Reporting Act, is the principal tool available to law enforcement to detect and investigate money laundering. Under these statutes, the Department of the Treasury has the responsibility for prescribing both the types of transactions that must be reported and the specific information that must be reported. The Secretary of the Treasury also has responsibility for supervising compliance with the reporting requirements. The Secretary has delegated this authority to the following regulatory agencies:

1. The Comptroller of the Currency for national banks and banks in the District of Columbia.
2. The Board of Governors of the Federal Reserve System for all state member banks of the Federal Reserve System.
3. The Federal Home Loan Bank Board for insured savings and loan institutions.
4. The Administrator of the National Credit Union Administration for Federal Credit Unions.
5. The Federal Deposit Insurance Corporation for all other federally insured banks.

6. The Securities and Exchange Commission for brokers and dealers in securities.

7. The Commissioner of Customs for transportation of currency and monetary instruments across national borders.

8. The Commissioner of the Internal Revenue Service for all other prescribed financial institutions.

Despite the large number of agencies assigned to monitor compliance with the reporting requirements on the Bank Secrecy Act, it is doubtful that compliance with the reporting requirements is being enforced. According to the Interim Report:

> Figures on the number of referrals made to the Treasury Department were not available from all participating agencies. The FDIC reported that, as of August 1984, three referrals for civil monetary penalties had been forwarded to the Treasury Department; in 1983, six; in 1981, one; and prior to 1980, three. As of July 1984, the SEC had referred four cases recommending imposition of civil money penalties against broker/dealers, as well as information about patterns of suspect transactions just below the $10,000 reporting requirement in certain brokerage houses. The FDIC and the SEC both report that to the best of their knowledge no penalties had been imposed on the referred institutions.
>
> The Treasury Department has informed the Commission that since the enactment of the Bank Secrecy Act in 1970, it has assessed civil money penalties against four financial institutions. * * * No civil penalty has ever been levied against an individual bank employee for violations of the Act. Interim Report, pp. 24-25.

The President's Commission on Organized Crime discusses a number of reasons for the low number of referrals and penalties. The Federal regulatory agencies responsible for monitoring compliance and reporting violations are primarily concerned with other matters. The bank regulatory agencies are primarily concerned with determining the soundness of the institution under examination. Problems also appear to exist in communications among agencies. However, one problem stands out far above the others: There simply is not enough personnel assigned to the task. See, Interim Report, pp. 18-20.

Problems with lack of sufficient investigative personnel also hamper investigations of suspected money launderers. When investigative resources are concentrated on money laundering investigations such as "Operation Greenback," an intense Treasury Department investigation into money laundering in Florida, dramatic results are achieved. See, Interim Report, pp. 26-27. However, concentrated investigations of this type appear to be the exception rather than the rule. All of the federal investigative agencies have substantial investigative duties in addition to money laundering and their limited resources must be allocated among all of their responsibilities. Consequently, there are not enough personnel assigned to investigate money laundering. Money laundering investigations are "labor intensive." Transactions must frequently be traced through voluminous and complex banking records; a very time-consuming process. Federal law enforcement agencies simply do not have sufficient personnel to conduct this type of investigation and still discharge all of their other responsibilities.

The President's Commission on Organized Crime has recommended that both the Secretary of the Treasury and the Attorney General be given substantial additional personnel to devote to money laundering investigations and Bank Secrecy Act compliance examinations. The Section endorses this recommendation. We believe that increasing the number of personnel assigned to money laundering investigations is the single most effective step that can be taken to combat money laundering.

3. The Bank Secrecy Act and the administrative regulations adopted pursuant thereto should be amended to require additional reporting of foreign transactions including certain transactions not involving currency or monetary instruments which are commonly used as money laundering transactions.

Most large sophisticated money laundering transactions use a foreign account or foreign transaction as part of the laundering scheme. In most cases, this transaction is conducted in a bank secrecy jurisdiction. Money launderers rely on foreign bank secrecy to conceal their transactions. Because of the territorial limits of U.S. jurisdiction, a legislative response to this aspect of the money laundering problem is, as a practical matter, limited. However, a key ingredient of any money laundering scheme is that the laundered funds ultimately be brought back to the United States so that they can be used. In most cases, the money is brought back through conventional banking channels. A reporting requirement, similar to that imposed on domestic currency and monetary instrument transactions would at least alert law enforcement authorities to potential foreign money laundering transactions. An exemption list similar to that used in domestic transactions could eliminate useless reports on established international businesses. The Section recommends that wire transfers of funds from foreign countries and the receipt of letters of credit or similar guarantees of loan repayment be reported.

In the long run, effective control over international money laundering depends on cooperation between governments. While some improvements in this area have been made in the past several years -- most notably, the agreement to exchange information with the Cayman Islands in narcotics cases -- much more needs to be done. Because of the seriousness of the narcotics problem in the United States, it must be recognized that this country is effectively at war with this problem and all of the diplomatic resources and sanctions available to the United States should be brought to bear to obtain international agreements to exchange information, particularly in narcotic cases.

III. COMMENTS ON LEGISLATIVE PROPOSALS

A. Creation of New Offense: "Laundering of Monetary Instruments

1. Recommendation of the Section

The Section recommends the enactment of a narrowly drafted statute to combat money laundering. Specifically, the Section recommends enactment of a money laundering statute that prohibits intentionally and knowingly engaging in financial transactions designed to conceal criminally derived property. The essence of money laundering is the concealment of the source of the funds, and it is this concealment that frustrates effective law enforcement. The enactment of the Section's proposed legislation would deter people from entering into potential money laundering transactions and would provide a means of prosecuting those who did. By retaining the traditional *mens rea* standard of intentionally and knowingly, it also minimizes the risk of conviction of innocent persons.

The term "criminal derived property," as used in the Committee's recommendation, has the same meaning as it does in H.R. 1474 discussed in section A. 2, below.

2. H.R. 1474

On March 7, 1985, Congressman William Hughes, Chairman, Subcommittee on Crime, House Judiciary Committee, introduced H.R. 1474 which creates the new offense of "Money Laundering." This bill provides as follows:

> (a) OFFENSE.--Whoever knowingly engages or attempts to engage in a financial transaction in criminally derived property shall be punished as provided in subsection (b).
>
> (b) PUNISHMENT.--(1) Except as provided in paragraph (2), the punishment for an offense under this section is--
>
> (A) a fine of not more than $1,000,000 or imprisonment for not more than 5 years, or both, if the offender is an individual; and
>
> (B) a fine of not more than $5,000,000 if the offender is a person other than an individual.
>
> (2) The court may impose an alternate fine to that imposable under paragraph (1) of not more than twice the amount of funds or monetary instrument in such financial transaction.
>
> (c) EXTRATERRITORIAL JURISDICTION. -- There is extraterritorial jurisdiction over an offense under this section.
>
> (d) DEFINITIONS.--As used in this section--
>
> (1) the term 'financial transaction' means the deposit, withdrawal, transfer, or exchange, of funds or a monetary instrument (as defined for the purposes of subchapter II of chapter 53 of title 31) by, through, or to a financial institution (as defined in section 5312(a)(2) of title 31); and
>
> (2) the term 'criminally derived property' means any property constituting, or derived from, proceeds obtained, directly or indirectly, from a criminal offense that is listed in section 1961(1) of this title.

This bill presents a more reasonable, well-balanced approach to money laundering than most of the proposed legislation. By retaining the traditional criminal mens rea standard of "knowingly," it reduces the risk of the conviction of innocent persons. However, this bill will reach transactions other than money laundering transactions and, therefore, the Section does not endorse it.

3. Administration Bill, H.R. 2785, H.R. 2786 and S. 1335

The Administration Bill, H.R. 2785, H.R. 2786 and S. 1335 also contain a new offense of money laundering. The Section opposes the enactment of a new offense of money laundering as defined in these bills. These bills provide:

> Section 1956. Laundering of Monetary Instruments
>
> (a) Whoever conducts, causes to be conducted, or attempts to conduct a transaction involving the movement of funds by wire or other electronic means involving one or more monetary instruments, which in any way or degree affects interstate or foreign commerce or conducts or causes to be conducted, or attempts to conduct such a transaction through or by a financial institution which is engaged in, or the activities of which affect interstate or foreign commerce in any way or degree --
>
> (1) with the intent to promote, manage, establish, carry on, or facilitate the promotion, management establishment or carrying on, of any unlawful activity; or
>
> (2) knowing or with reckless disregard of the fact that such monetary instruments or funds represent the proceeds of, or are derived directly or indirectly from the proceeds of, any unlawful activity shall be sentenced to a fine of not more than $250,000 or twice the value of the monetary instruments or wire transferred funds, whichever is greater, or imprisonment for not more than twenty years, or both.
>
> (b) Whoever conducts, causes to be conducted, or attempts to conduct a transaction described in subsection (a) is liable to the

United States for a civil penalty of not more than the greater of --

(1) the value of the funds or monetary instrument or instruments involved in the transaction, or

(2) $110,000.

(c) As used in this section --

(1) the term 'conducts' includes but is not limited to initiating, concluding, or participating in initiating or concluding the transaction.

(2) the term 'transaction' includes but is not limited to a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes but is not limited to a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale any stock, bond, certificate of deposit, or other monetary instrument, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected;

(3) the term 'monetary instrument' means coin or currency of the United States or of any other country, traveler's checks, personal checks, bank checks, money orders, investment securities in bearer form or otherwise in such form that title thereto passes upon delivery, and negotiable instruments in bearer form or otherwise in such form that title thereto passes upon delivery;

The Section strongly opposes the enactment of the new offense of "Laundering of Monetary Instruments" in the form contained in the Administration Bill, H.R. 2785, H.R. 2786, S. 1335. The Section believes no need has been shown for this new far-reaching criminal offense. The Section believes that the 'reckless disregard' mens rea standard contained in the bill is an inappropriate criminal intent standard. Similarly, the Section also opposes the "reason to know" mens rea standard proposed by the President's Commission on Organized Crime and contained in H.R. 1367, H.R. 1945 and S. 572.

The Section also opposes the Administration Bill and H.R. 2785, H.R. 2786 and S. 1335 because of the broad definition of "unlawful activity" contained in these bills. Unlawful activity is defined in this legislation as any state or federal felony. By virtue of this definition, all state felonies involving money are federalized. This provision destroys the division of responsibilities in law enforcement between the states and federal government that has existed since the founding of the country.

The Section is also opposed to the creation of this new offense because of the expanded authority to conduct electronic surveillance it would grant to federal law enforcement agencies. In the Comprehensive Crime Control Act of 1984, violations of the Bank Secrecy Act were added to the list of offenses for which federal law enforcement agencies could apply for a warrant to conduct electronic surveillance. The extremely broad definition of "unlawful activity" contained in the proposed legislation dealing with money laundering will greatly expand the authority of federal agencies to conduct electronic surveillance. The Section feels this is neither necessary nor desirable.

4. Need for Specific Legislation dealing with Money Laundering

The Section agrees there is a need to strengthen, simplify and streamline statutes relating to money laundering. However, the Section questions whether any compelling need has been demonstrated for the passage of the legislation as sweeping as that proposed by the Administration. As noted earlier in this report, the major problem with money laundering has been its detection, not prosecution of it once it has been discovered. Existing statutes more than adequately provide the basis for prosecuting money laundering. The following is a list of statutes applicable to money laundering which appears in a monograph published by the Narcotics and Dangerous Drug Section, Criminal Division, U.S. Department of Justice, entitled "Investigation and Prosecution of Illegal Money Laundering," Chapter 5, pp. 100-101:

> I. Statutory Violations Utilized in Illegal Money Laundering Investigations
>
> A. Pertinent Statutory Provisions
>
> The following is a list of the primary offenses utilized in Title 31 investigations and prosecutions:

(1) Title 18 offenses

  a. Section 1001 (false statement and concealment of material facts);

  b. Section 1005 (false bank entries);

  c. Section 1007 (false statements to the FDIC);

  d. Section 1014 (fraudulent loan applications);

  e. Sections 1341 and 1343 (mail and wire fraud);

  f. Section 1952 (ITAR);

  g. Section 1961, et seq. (RICO); and

  h. Section 371 (conspiracy to commit a specific violation or to defraud the United States).

(2) Title 26 offenses (related to the obtaining of income from narcotics sales or other sources and the failure to report or to falsely report this income).

(3) Title 21 offenses (related to the importation, manufacture, sale and possession of narcotics with intent to distribute; conspiracy; and continuing criminal enterprise).

(4) Title 31 offenses

  a. Section 5313(a) (currency transaction reports at financial institutions involving cash or equivalent over $10,000);

  b. Section 5316 (currency or monetary instrument reports at the United States border involving the transportation of

> cash or its equivalent over $5,000 [now, $10,000]);
>
> c. Section 5321 (foreign bank account reports);
>
> d. Section 5322 (penalties); and
>
> e. 31 C.F.R. Part 103 (regulations concerning currency reporting except sections 103.31 - 103.37).
>
> (5) Title 12 offenses (relating to the recordkeeping requirements pertaining to persons having interests in foreign financial accounts and to financial institutions in Sections 1829b and 1951 et seq. and regulations in 31 C.F.R. Secs. 103.31 - 103.37).
>
> The above statutes and regulations are those most frequently involved in narcotics-financial cases. Perjury, obstruction of justice, bribery, extortion and other offenses, may also be involved. (Footnotes omitted)

As a footnote makes clear, the use of the above-cited statutes is not limited to money laundering related to narcotics violations:

> While this chapter does not deal directly with the financial aspects of cases that involve federal violations which are not related to narcotics violations or with any state or local offenses, it should be clear that the use of the Title 12, 18, 26, and 31 offenses described herein can be used in conjunction with the investigation and prosecution of activities such as illegal gambling, arson, bribery, extortion, stolen property, weapons violations and labor violations in addition to legally generated money laundering schemes devised to evade paying taxes or to distort net worth in divorce proceedings.

B. Creation of New Offense - Facilitating an Offense

The Administration's proposed money laundering bill would create a new crime of "Facilitation" by adding an additional subsection to Title 18, U.S.C. § 2, the Aiding and Abetting Statute. The proposed new subsection is as follows:

> (c) Whoever knowingly facilitates the commission by another person of an offense against the United States by providing assistance that in fact is substantial is punishable as a principal.

The Section is opposed to the creation of this new offense. The proposed new crime of facilitation is a statute of broad general applicability not limited to money laundering violations. The need for such a broad new statute has not been demonstrated. The Honorable Jay B. Stephens, Associate Deputy Attorney General stated, in testimony before the Committee on the Judiciary, Subcommittee on Crime, on July 24, 1985, that this new statute was needed to reach the situation where an individual, for a fee, took currency that he knew was derived from a drug transaction and exchanges it for cashier's checks which he then returns to the drug dealer. No new statute is needed to deal with this situation. This situation can easily and successfully be prosecuted under existing federal law. Both the conspiracy statute (18 U.S.C. § 371) and the aiding and abetting statute (18 U.S.C. § 2) are applicable to this situation.

The Section also opposes enactment of this new statute because it is designed to inflict criminal punishment upon conduct that does not rise to the level of purposeful assistance required in the aiding and abetting statute. The proposed facilitation offense is a dangerous departure from the well established concepts of both legislation and case law which have recognized that knowledge of the commission of a crime, coupled with association with the criminal is not a sufficient basis for a criminal conviction. See, United States v. Roberts, 619 F.2d 379, 383 (5th Cir., 1980).

C. Amendments to Statutes and Rules of Criminal Procedure Dealing With Grand Jury Practice

1. Amendment to Rule 17(c), Federal Rules of Criminal Procedure

The Administration bills would amend Rule 17, Federal Rules of Criminal Procedure, to expressly authorize a District Court, upon application of the government, to order a person to whom a subpoena is directed not to notify anyone of the existence of the subpoena for a specified period of time. Since this provision would be added only to subsection (c) of Rule 17, it should apply only to subpoenas duces tecum, but not to subpoenas (governed by subsection [a]) solely for the attendance of witnesses. This limitation was clearly intended by the drafter of the bill, as reflected in the further provision that the order be issued only if the court determines that "there is reason to believe that the books, records, documents, or other objects designated in the subpoena are relevant to a legitimate law enforcement proceeding . . ." (Emphasis added). The court must also determine that there is "reason to believe" that notice to others of the existence of the subpoena would endanger any person, or result in flight, destruction of evidence or intimidation of witnesses, or otherwise impair the investigation or trial.

The Section believes that while it is appropriate in certain limited cases to order a grand jury subpoena respondent not to disclose the existence of a subpoena to a putative defendant, the proposed legislation is much broader than required to achieve this goal and potentially could infringe on substantial rights of both the putative defendant and the subpoena respondent.

The Administration bill would direct the subpoena respondent "not to notify any other person of the existence of the subpoena." Under this proposed statute, a witness would be prohibited from even consulting his own attorney regarding the subpoena. The Section is of the opinion that the prohibition against a witness consulting with his counsel regarding the subpoena is unconstitutional and a violation of the fundamental rights of the witness. The Section is opposed to any nondisclosure statute which burdens either the accused or the witness's right to counsel.

Although a nondisclosure order is most likely to be sought at the grand jury stage, the proposed amendment is not so limited, and could be invoked to bar disclosure of trial subpoenas as well. The Section believes that the imposition of a nondisclosure order with respect to a trial subpoena in any but the most extraordinary circumstances would unfairly hamper a defendant's ability to prepare a defense and confront the witnesses against him. The Section is opposed to any nondisclosure statute which is applicable to trial subpoenas.

Entry of a nondisclosure order seriously impairs the ability of a defendant to prepare his defense. Even in the grand jury stage of criminal proceeding, it is necessary for a putative defendant to be preparing his defense. In complex criminal cases, it is, as a practical matter, essential that the defense preparation begin during the grand jury stages because the time limitations imposed by the Speedy Trial Act make it impossible to prepare the defense between indictment and trial. In most cases, the putative defendant is also offered the opportunity to testify and present his defense to the grand jury. Knowledge of the case and evidence is essential if the putative defendant is to make an intelligent choice of whether to testify or not testify. Consequently, the Section opposes the proposed amendment to Rule 17(c).

2. Amendments to the Right to Financial Privacy Act

Subsection 3(f) of the Administration Bill deletes a provision in the Right to Financial Privacy Act that requires that financial records obtained from a customer from a financial institution pursuant to a grand jury subpoena must be returned and actually presented to the grand jury. The purpose of this provision according to the Administration's line-by-line analysis is that this unique requirement for physical presentation of documents to the grand jury is burdensome and costly. It also states that it serves no legitimate privacy interest because other provisions in the Right to Financial Privacy Act regarding grand jury records and Rule 6 of the Federal Rules of Criminal Procedure adequately protect unauthorized use of the subpoenaed records.

The Section opposes the enactment of Subsection 3(f) of the Adminstration Bill. The use of grand jury subpoenas and judicial process to obtain records for the use of prosecutors and investigative agencies is a well recognized abuse which has been condemned by the courts. See, United States v. Thomas, 320 F. Supp. 527, 530 (D.D.C, 1970) (prosecutor ordered to "cease sending to prospective witnesses . . . before the trial date any form which includes the word 'Summons' or any derivative thereof or which in its format and language resembles an official judicial subpoena or similar judicial process or which conveys the impression that non-appearance is subject to sanction . . ."). It has also been held improper for a prosecutor to arrange for the issuance of a proper subpoena for the sole purpose of interviewing a witness personally. See, e.g., In re Lopreato, 511 F.2d 1150 (1st Cir., 1975); Durbin v. United States, 221 F.2d 520 (D.C. Cir., 1954). The grand jury is the constitutionally created independent body which stands between the accusing government and the citizen. Enactment of legislation which suggests that the grand jury process can be used for other than grand jury purposes degrades the legitimate function of the grand jury and turns it into an arm of the prosecution.

D. Creation of New Offense: "Receiving the Proceeds of a Crime"

Section 8 of the Administration Bill would create a new offense "Receiving Proceeds of a Crime." The proposed statute is as follows:

> Whoever receives, possesses, conceals, or disposes of, any money or other property which has been obtained or attempts to receive, possess, conceal, or dispose of, any money or other property which has been obtained in connection with a violation of any law of the United States for which the punishment may extend to imprisonment for more than one year; or brings or transfers into the United States any money or other property which has been obtained in connection with the violation of any law of a foreign country concerning the manufacuture, distribution, or any other form of trafficking in any substance listed in the current schedules of controlled substances established pursuant to Section 202 of the Controlled Substance Act (21 U.S.C. 812) for which the punishment under the law of the foreign country may extend to imprisonment for a period of more than one year, knowing or believing the same to be money or property which has been obtained in violation of law, shall be imprisoned for not more than ten years, or fined not more than $250,000 or both.

The Section is opposed to the enactment of the new statute dealing with receiving the proceeds of a crime. The Section specifically objects to the mens rea standard of the bill, "knowing or believing the same" to be property obtained in violation of law. This statute would allow conviction on the impossibly subjective test of the "belief" of an accused, a standard which invites the conviction of the innocent.

The Section is also opposed to the enactment of the new offense of Receiving the Proceeds of a Crime as presently drafted because of its likely infringement upon the Sixth Amendment right to counsel. Under the proposed legislation, it is unlikely that an attorney could accept a fee from a client who had possibly engaged in criminal activity. Under the impossibly subjective standard of believing, any attorney could be accused of a felony merely on the basis of his receipt of fees from a client with the only issue at trial being what the attorney believed about the source of the client's money. Consequently, the right to the defense by counsel of one's choice will effectively be destroyed by enactment of this legislation.

E. Forfeiture of "Laundered" Funds

Several of the proposed bills including the Administration Bill, H.R. 2785, H.R. 2786, and S. 1335, contain forfeiture provisions which broadly expand the scope of the current federal forfeiture laws to cover all state and federal felonies. The Section strongly opposes enactment of these forfeiture provisions. The widespread statutory authority for civil and criminal forfeitures under current law raises substantial doubts about the need for extending these sanctions to these new, and untested, criminal offenses. Ample statutory authority exists for civil and criminal forfeitures for violations of many current federal offenses. See, e.g., 18 U.S.C. § 1963 (RICO, which includes currency reporting violations as a predicate offense); 21 U.S.C. § 853 (all drug offenses); 21 U.S.C. § 881 (civil forfeiture for drug violations); 31 U.S.C. § 5317(b) (civil forfeiture for illegally transporting currency and monetary instruments).

The Section also believes that the proposed forfeiture legislation will unduly infringe on the Sixth Amendment right to counsel and represents an unwarranted increase in criminal penalties. As presently drafted, the forfeiture provisions contain many ambiguities which will place an unwarranted additional burden on the Federal Judiciary.

The forfeiture sanctions in the proposed legislation contain many statutory ambiguities. The proposed criminal forfeiture provisions of the Administration Bill, S. 1335, H.R. 2785 and H.R. 2786, contain a new definition of forfeitable property geared toward the new substantive offenses in these bills. The general description of forfeitable property as "any money or other property involved in such an offense" fails to identify what is the required nexus between the defendant, the offense, and the property. For example, does "property involved in an offense" include only property actually used to violate these offenses? A broad interpretation of the flexible phrase "involved in" might lead a court to conclude that a defendant's entire bank account, mortgage, stock, or equitable interest in an asset would be subject to forfeiture regardless of the nexus between the property and the defendant's criminal conduct. Under this interpretation, a $10 deposit, for example, would render an entire bank account forfeitable. The Section believes such a result is unjust and inequitable.

Application of the flexible phrase "involved in" to the classic money laundering scheme also highlights the imprecise fit between the term and the targeted offense. If a bank teller accepts a deposit of illicit funds, these funds are "involved in" a substantive offense but they are also not the teller's funds to forfeit. If deposits are the targeted evil, then the threat of a prison term is the only sanction available against the teller. Of course, current forfeiture law would apply with full vigor to the depositors' illicit monies.

In a similar manner, the additional description of forfeitable property as that "which represents the proceeds of or which is traceable to such money or property" is equally ill-phrased. If Congress wants to reach the "proceeds" of illicit activity, it can do so by using the word "proceeds." See, e.g., 18 U.S.C. § 1963(a)(3); 21 U.S.C. § 853(a)(1). Adding the prefatory words "which represents the" can only lead to ambiguity as to what Congress has attempted to describe. Additionally, the proposed statute's listing of property "which represents the proceeds" as an alternative to property "traceable to such money" raises a fundamental question as to the meaning of "proceeds" in the first place.

The relation back provisions of the proposed legislation also create new ambiguities. The relation back doctrine, which establishes the legally operative point of title transfer from the defendant to the government, is triggered by the "commission of the act giving rise to forfeiture." 21 U.S.C. § 853(c). The proposed money laundering offense, however, is predicated on the use or attempted use of a financial institution as a conduit for funds emanating from "unlawful activity." If the unlawful activity is considered the "act giving rise to forfeiture" then title vests in the federal government from the operative date of every state and federal felony offense. Conversely, if the use of the "financial institution" constitutes the "act giving rise to the forfeiture," then some clarification of the triggering financial event (i.e., deposit, withdrawal, extension of credit, etc.) would appear necessary. Again, the ambiguity is created not by the doctrine itself but rather by its wooden application to a broadened class of criminal conduct without reference to the enforcement needs that inspired the criminal offense in the first place. All of these ambiguities are not contained in the current criminal forfeiture laws.

The "substitute asset" provisions of the proposed legislation are also extremely troublesome. These provisions are even more ambiguous than those regarding property forfeitable as a direct result of the defendant's criminal conduct. There are serious constitutional problems with this portion of the proposed legislation. A similar (although not as broad) substitute asset provision was deleted by the Conferees for the Comprehensive Forfeiture Act of 1984. See, Conference Report, No. 1159, 98th Cong. 2d Sess. 419 (1984). The House Report rejected the concept of substitute assets forfeiture and noted the similarity of the concept to the constitutional prohibition against forfeiture of estate. The Report stated:

> At the present time the proposed 'substitute asset' provision appears to be ill-advised, unworkable and the need for it has not been substantiated. Any attempt to forfeit 'substitute assets' which has no nexus to the crime 'in personam' forfeiture is a giant step in the direction of 'forfeiture of estate' and would needlessly raise constitutional questions which could jeopardize successful prosecutions under this bill for years to come.

H. Rep. No. 845, Part I, 98th Cong. 2d Sess. 12 (1984). The House and Senate Conferees on the Comprehensive Crime Control Act of 1984 apparently agreed with this assessment; the "substitute assets" provision in the Comprehensive Forfeiture Act was deleted. Wholly apart from whether the imposition of "substitute" forfeiture penalty constitutes a prohibited forfeiture of estate, the imposition of criminal forfeiture in a criminal prosecution on assets unrelated to the defendant's criminal conduct raises substantial questions of due process.

The proposed "substitute assets" provision set forth in the Administration Bill, S. 1335, H.R. 2785 and H.R. 2786 goes even further than the prior substitute assets language previously rejected by the 98th Congress. Under the proposed "substitute assets" language, mandatory forfeiture is imposed not only for the affirmative acts of a defendant which diminish the assets available for forfeiture, substitute assets can be forfeit as a result of the defendant's failure to act in a way which maximizes the assets available for ultimate forfeiture. Thus, the defendant will be placed in the incongruous position of being a trustee or fiduciary to the government's unsecured claim of title from the moment of the operative criminal act. Enactment of this proposed legislation will require the federal judiciary to engage in a historical analysis of the relative success of the defendant's investment strategy for purposes of determining the defendant's current forfeiture liability.

For the preceding reasons, the Section strongly recommends against the adoption of the proposed expanded forfeiture sanctions.

Paul B. Johnson
Chairperson

February, 1986

AMERICAN BAR ASSOCIATION

SECTION OF CORPORATION, BANKING AND BUSINESS LAW

CONSIDERATION OF THE RECOMMENDATION OF THE SECTION OF CRIMINAL JUSTICE ON PROPOSALS TO CONGRESS FOR COMBATTING MONEY LAUNDERING

This Commentary summarizes the discussions by the Section of Corporation, Banking and Business Law at its Mid-Winter Meeting on January 18, 1986, concerning the request from the Section of Criminal Justice of the American Bar Association to support that Section's Recommendation on Money Laundering ("Recommendation").

The Section of Corporation, Banking and Business Law ("Section") agrees with the general tenor of the Recommendation and with many of the positions set forth in the Report accompanying it ("Report"). There are specific areas in the Report, however, with which the Section has problems.

As defined in the Criminal Justice Section's Report, "money laundering" is defined as the

> process used to conceal the source of illegally obtained funds. In some cases, it is also used to facilitate other crimes such as tax evasion, smuggling and bribery.

The Section of Corporation, Banking and Business Law shares the common concern of the law enforcement community and others over the use of the payment system of this country to further the expansion of criminal conduct and to hide evidence of criminal activity through the use of sham transactions, agents, and other devices which are designed to shelter the fruits of illegal activity. For this reason, the Section supports the general concepts embodied in the Section of Criminal Justice's Recommendation. This support of the Recommendation, however, does not embrace all details of the accompanying Report.

On page 7 of the Report under the subheading of "Commentary on Recommendations," there is a provision that the Bank Secrecy Act be amended to provide for faster notification of money laundering transactions. The Report suggests that the present reporting system, which calls for reports to be filed within 15 days, be changed to a one business day standard and that in certain "suspicious transactions" a telephone notification be given within one business day of the transaction. Also a postcard notification procedure is suggested.

From our experience and contacts with various financial institutions, it is not believed that a one day reporting requirement is feasible and that it would result not only in enormous operating burdens and costs which appear to exceed the benefit contemplated, but it would also be extremely difficult, if not impossible, to achieve. The current regulations specifying a 15-day reporting period were negotiated earlier with the financial institutions based upon operating restraints. The Report states that there have been instances of reports being submitted long after the present reporting period. There is no indication that this is a wide-scope problem, nor is there a showing that late reporting is a problem that cannot be cured under present regulations through normal enforcement efforts.

In the absence of more specific evidence supporting the shortened notification period, we feel that the increased reporting burden and costs would not warrant the change of reporting periods.

The reporting of "suspicious transactions" within one business day by telephone also has inherent problems. The determination of what constitutes a "suspicious transaction" cannot normally be made at the input level of these transactions and has to be reviewed against the background of the transaction, the relationship of the customer with the institution (if known or can be ascertained), and a judgment decision by supervisory personnel who are more experienced than an input clerk who is trained to handle a large volume of items but not to make value judgments. This appears to be a necessary division of labor within a financial institution which enables the operating process to work. A one day reporting requirement would be unfeasible and the subjective judgment of "suspicious transactions" obviously is a difficult one.

Additionally, the "suspicious transaction" proposal in the Report may raise major problems with privacy considerations and may cause a conflict with the Right to Financial Privacy Act (12 U.S.C. 3401, 3402).

The postcard notification suggested in the Report would not relieve the reporting burden that currently exists since a supervisory review must be made and a paper trail of the reporting to the proper governmental authority would have to be maintained by the reporting institution. Reactions from inquiries we have made are that the current reporting method is generally adequate for its purpose and that nothing would be achieved with a postcard reporting mechanism since the operating procedures would not materially change and might become somewhat cumbersome.

The Report calls for a new threshold reporting standard of $2,000.00 to be applied to cashier's checks when purchased by non-accountholders and which require more than one business day to complete the transaction. The determination of whether or not the purchaser is a non-accountholder would require financial institutions with their branch systems to have the capability gain immediate access to a bank's multiple account files so that the report could be made. Very few banks have computer systems which integrate customers' files enabling them to make an automated review of their overall relationships. Such systems are very expensive to create and the maintenance and updating cost is equally expensive. This proposal would result in a manual review of reportable cashier's checks in the banking system and would create a large reporting burden, both in operations and in cost. Additionally, a surveillance system of this type could be easily avoided. For example, to avoid the reporting threshold, a $2,000.00 cash transaction would be easy to do to escape detection.

On page 13 the Report recommends that reporting requirements extend to wire transfers of funds from foreign countries, for letters of credit and for similar guaranty-type instruments. Exemptions would be provided for "established international businesses." If a major percentage of these transactions did not qualify for the exemption, the reporting burden, cost, and flow of paper would be enormous. Even if they did qualify for non-reporting, the monitoring, cross-checking, and review process could still be onerous. It is believed that one major bank receives as many as 9,000 international wire transfers a day, which, when compounded with the volume from the total banking industry, would dangerously narrow the existing bottlenecks in the regulatory mechanism (which, from the Report, is a major delay problem with present volumes). For letters of credit the problem would be similar. It is believed that over the last four years the Department of Commerce averaged approximately 30,000 boycott reports a year, of which letters of credit were a large percentage. Of the total number of letters of credit which flow through the American banking system each year, so-called boycott transactions would be a very small portion of the total. The number of reports of letters of credit arising from this proposal would be huge, with resulting cost and management problems vastly increasing. Obviously, what is needed is the striking of a balance between the need of government to know and the ability of the reporting institutions to manage and to support the cost and reporting overhang.

There is no question that international cooperation is a critical cornerstone of controlling money laundering. This requires sourcing foreign based information which is an area of extremely delicate negotiations presently going on between countries like Switzerland, England, France, and Germany, which have very restricted transborder data flow laws based upon their concerns over confidentiality and privacy. These laws presently raise significant compliance obstacles for financial institutions in responding to requests for information domiciled in their foreign branches. Until such time as diplomatic negotiations can resolve the restrictions on disclosures in laws of given foreign countries, requirements of U.S. law mandating a foreign or domestic bank to produce records and information maintained in an office or branch outside the United States will create impasses for which the courts have not yet developed an intelligent or practical resolution. Evidence of these problems is clearly of record in cases which have been decided or are currently pending in the states of New York and Florida.

It would appear that placing further legislative mandates in an area which we believe is already under substantial international strain may be counterproductive at this time. Both England and France have enacted "blocking" statutes to prevent U.S. courts or agencies from reaching data held in those countries even if held by a branch of a U.S. bank. Hong Kong courts have issued orders prohibiting the disclosure of certain information deemed protected by their privacy laws, and Canada has pending before Parliament legislation which would be similar to the English "blocking" statutes.

Again, the Section supports the general concepts contained in the Recommendation, but is not able to support specific suggestions in the accompanying Report which are described in this Commentary.

STATEMENT

OF

EARL B. HADLOW

on behalf of the

AMERICAN BANKERS ASSOCIATION

on

various proposals

to amend the

Currency and Foreign Transaction Reporting Act

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTION SUPERVISION,

REGULATION AND INSURANCE

of the

HOUSE COMMITTEE ON BANKING, FINANCE

and URBAN AFFAIRS

May 14, 1986

Mr. Chairman and members of the committee: I am Earl B. Hadlow, Vice Chairman and General Counsel of Barnett Banks of Florida in Jacksonville, and a member of the American Bankers Association Government Relations Council. The combined assets of the members of our Association comprise approximately 95 percent of the industry total. Our members range from the smallest to the largest banks, and close to 85 percent of them have assets of less than $100 million. I welcome the opportunity to present ABA's views on H.R. 1367, H.R. 1474, H.R. 1945, H.R. 2785, H.R. 3892, H.R. 4280, H.R. 4573 and Titles I, VI and XI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.

A number of the bills that have been introduced will amend the Currency and Foreign Transaction Reporting Act (Bank Secrecy Act); severely weaken the Right to Financial Privacy Act (RFPA); and create a federal crime of money laundering.

The ABA understands the challenge that law enforcement officials face in attempting to combat drug trafficking and organized crime. The use of financial institutions as havens for drug money is as abhorent to our members as it is to the public in general. We want to maintain a balance between the legitimate needs of law enforcement and the legitimate need to protect our customers privacy from unlimited governmental intrusion.

Our feelings were best summed up by Mr. R.L. Wood when he appeared before the House Committee on Ways and Means on July 18, 1975, and I quote:

> "The right of privacy of an individual's financial records...in the absence of a known violation of law by the individual involving his finances...is an integral element of the American concept of political rights of the individuals. These rights have been characterized as being protected under our Constitution and under the common law."

Mr. Wood's remarks were based upon our policy as expressed by the General Counsel of the American Bankers Association in 1940, when he said:

> A bank should, as a general policy, consider information concerning its customers as confidential, which it should not disclose to others without clear justification. Milohnich v. First National Bank of Miami Springs, 224 So.2d. 759, 761 (1969).

A small number of financial institutions have been fined for failure to file the reports required by the Bank Secrecy Act. In cases where employees of the financial institutions have conspired with criminal elements to evade the reporting requirements, individuals have been brought to trial by the Department of Justice. The violations of the reporting requirements have exacted a swift response by our banks. The industry has dramatically increased it's educational programs and compliance efforts. The financial industry's repeated requests for practical solutions, have thus far only been met by echoes of our inadvertent reporting failures. Now is the time to focus on the future, not dwell on the past.

The numerous bills now pending before this Committee reflect the concerns of Congress about the problem of drug trafficking. As this Committee focuses on possible solutions to that problem, you should follow the admonition of your Chairman, "to enact something now that is universally acceptable," universally acceptable legislation will maintain the "proper regard for civil liberties," and will also throw the gauntlet down against money laundering transactions."

The first step toward solving the problem is to separate out those issues that will prevent the enactment of acceptable legislation. The two proposals that we believe will prevent immediate action are a new crime of money laundering and amending the Right to Financial Privacy Act.

The ABA continues to support making money laundering a crime. However, the process of criminalizing money laundering demands broad-based discussions on its possible ramifications. The shaping of the crime must be done with a scalpel, not a shotgun. Therefore, now is not the time to tackle a new Title 18 crime.

As you are aware, Mr Chairman, a number of proposals repeal the procedural safeguards found in The Right to Financial Privacy Act. We are not convinced that the procedural protections in the RFPA severely hamper law enforcement activities. Therefore, we do not believe it should be amended in any fashion.

H.R. 1367 as introduced by Representative McCollum (R-FL) contains many of the recommendations made in the Interim Report of the President's Commission on Organized Crime. Included in H.R. 1367 are a new crime of money laundering, changes in the Federal wiretap statute, and changes in the Right to Financial Privacy Act.

H.R. 1367 would also expand the authority of the Secretary of the Treasury under the Bank Secrecy Act (BSA). The Secretary would be given the authority to examine any data or records of a domestic financial institution required by the recordkeeping requirements of BSA. In addition, the Secretary could summon an officer or employee of a financial institution to appear before the Secretary or his delegate and produce such records, data, or sworn testimony as may be relevant or material.

The bill proposes making judicial orders authorizing wiretaps for the interception of telephone calls, telexes, and other forms of wire or oral communications available for investigations of possible violations of the criminal provisions of the Bank Secrecy Act (i.e. willful violations of the reporting requirements) and of the proposed crime of money laundering.

H.R. 1474 as introduced by Representative Hughes (D-NJ) creates a new crime of money laundering and requires individuals to file directly with the Secretary of the Treasury for exemption from the BSA reporting requirements.

H.R. 1945, as introduced by Representative Hubbard, contains two titles. First, The Drug Money Seizure Act which would increase the penalties for a willful violation of the Bank Secrecy Act. As proposed, the current civil penalty of $10,000 would be increased to the amount of the transaction where the violation involved a transaction reporting requirement. This provision introduces the concept of forfeiture as a penalty. Mr. Hubbard's bill also grants the Secretary of the Treasury summons authority. This is a response to the assertion by the Department of the Treasury that it lacks subpoena power sufficient to enforce the Bank Secrecy Act. If the Congress finds the current means of obtaining a subpoena available to the Secretary of the Treasury are inadequate to enforce the Act, we would support the expansion of the Treasury's subpoena authority as proposed. Second, H.R. 1945 creates a crime of money laundering.

H.R. 2785 ("the Administration bill"), as introduced by Representatives St Germain and Wylie at the request of the Administration, creates among other things a new crime of money laundering, amends the Federal Rules of Criminal Procedure, and establishes criminal and civil forfeiture under Title 18.

H.R. 2785 also gives the Secretary of the Treasury authority to examine records, papers, and other data of the financial institution relevant to the reporting requirements of the Bank Secrecy Act. The financial institution could be required through a summons to produce at its own expense such documents and records at any location within 500 miles of the institution's place of business.

H.R. 3892, as introduced by Representative Wortley, would require the Secretary of the Treasury to review all exemption lists on an annual basis and, in a case of a change in bank control or management, the Secretary would be required to review the exemption list within 30 days. Additionally, H.R. 3892 would amend the Federal Deposit Insurance Act and the National Housing Act by extending the time frame within which supervisory agencies could review change of bank control applications for compliance with the Bank Secrecy Act.

Finally, H.R. 3892 would recycle the proceeds of seizures and forfeitures from any unlawful act back into the enforcement of the Bank Secrecy Act.

H.R. 4280, as introduced by Representative Torres, would increase the recordkeeping of financial institutions by requiring extensive records on all currency transactions of $3,000 or more to be kept for 5 years. This is an attempt to increase information available for investigations. This proposal will obviously increase the amount of records a financial institution will be required to keep, however, the utility of the proposal is unclear.

H.R. 4573, as introduced by Representative Pickle, would deal with the problem of structured transactions or "smurfing" by making it a crime to cause or attempt to cause a financial institution to fail to properly file a Currency Transaction Report on a transaction. Proceeds or property interests directly traceable to the failure to file would be subject to seizure or forfeiture. We believe H.R. 4573 is a cogent attempt to stem the evasive tactics of money launderers. It focuses everyone's attention on the motivation of the drug trafficker.

As mentioned above, "structuring" or "smurfing," allows criminals to exchange illegally derived monies for cashiers checks, travelers checks, etc. Mr. Pickle's approach would subject persons to civil and criminal liability for causing or attempting to cause a domestic financial institution to "fail to file a (currency transaction) report", or to file the report with "a material omission or misstatement of fact" or structuring or assisting in structuring a transaction "for the purpose of evading the reporting requirements." This language will address the structured transaction problem which has forced the courts to dismiss charges against individuals who may have been involved in deliberate evasion of the Bank Secrecy Act reporting requirements.[1]

While there have been several cases that have found "structured transactions" violative of 31 U.S.C. 5313(a)[2], the confusion over the statute and its implementing regulations needs to be solved once and for all; otherwise dismissals of charges such as that in the recent United States v. Dela Espriella[3] will continue.

ABA would like to suggest to this Committee another proposal, already offered in the Senate by Senator DeConcini and very similar to Mr. Wortley's proposal in H.R. 3892, which would complement this Committee's response to tightening the Bank Secrecy Act. Senator DeConcini introduced S. 1385, the "Money Laundering Crimes and Disclosure Act" which deals in part with the reporting problem associated with currency transaction report exemptions. S. 1385 would amend 31 U.S.C. 5318, which gives the Secretary of the Treasury authority to "prescribe (or revoke) an appropriate exemption" by requiring the financial institution to provide to the Secretary of the Treasury (or his delegate) "a list of customers of the financial institution whose transactions have been exempted" and by further requiring the Secretary to "review and approve or revoke the list of exemptions within 90 days after the date of receipt." If the Secretary failed to notify the financial institution within the time provided, the exemption list would be deemed approved. These proposed changes would encourage frequent review of the CTR exemption lists and provide financial institutions with an incentive to internally review and update their lists. These reviews would guarantee that the lists are used only for their intended purposes: to exclude from the reporting requirements only those customers clearly intended to qualify under the regulations.

Additionally, we would like to suggest some new language relating to an internal audit of the financial institution. Specifically, a section such as the following should be added:

> "No liability for a civil penalty shall be imposed upon a financial institution for a violation of this subchapter or a regulation prescribed under this subchapter if such violation is first discovered by such financial institution and is promptly disclosed by such financial institution to the Secretary or in accordance with regulations prescribed by the Secretary."

This amendment provides that liability for a civil penalty will not be imposed upon financial institution for violations of the Bank Secrecy Act or regulations thereunder if the financial institution discovers such violations and promptly discloses them to the Treasury Department. The purpose of this amendment is to encourage financial institutions to audit for Bank Secrecy Act compliance and to disclose and report negligent failures to comply with the Act. Absent such a provision, the consequences to the institution would be the same whether violations were discovered in the course of an internal audit or an external examination. Since the amendment will induce financial institutions to ensure full compliance, it will further the general purposes of the Bank Secrecy Act.

There have been numerous proposed solutions aimed at curbing drug trafficking. Our Association supports the Chairman's goal of immediate, effective action. This goal can only be met by putting aside the all-encompassing proposals in the Administration's bill and by enacting the practical approach embodied in H.R. 4573. We believe that H.R. 4573 along with certain provisions in H.R. 1945 represent these universally acceptable solutions.

The penalties in H.R. 1945 attach to a domestic financial institution and a partner, director, officer, or employee of a domestic financial institution. H.R. 4573 extends the reach of penalties to persons outside the financial institution. Under H.R. 4573, any person who causes or attempts to cause a domestic financial institution to fail to file a report required by the Bank Secrecy Act or to file a report containing a material omission or misstatement of fact would be subject to civil penalties in the form of the forfeiture provisions. United States coin, currency, monetary instruments, or any other interest property traceable to such instruments, coin or currency could be seized and forfeited to the U.S. Government.

We believe the forfeiture proposal presents an issue which needsclarification: that is, the extent of the reach of forfeiture should be more precisely defined.

The forfeiture subsection covers funds and assets that are "traceable" to the coin or currency involved in a violation or attempted violation of the Bank Secrecy Act. The limits of the "reach" of forfeiture need to be clarified. Even though it is the intent of the proposal that no property or interest in property shall be forfeited if it can be established that the owner is a bona fide purchaser for value who took without notice of the violation; or if the violation was not willful, the language offers no protection or immunity to innocent sellers or innocent parties to a transaction who accept collateral that may indeed be "traceable" to tainted funds. While the Association supports the concept of forfeiture as a

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method of arresting the process of legitimization of illicit drug profits, we offer this support with a concern for the need to protect all innocent participants to legitimate business transactions.

Both H.R. 1945 and H.R. 4573, focus on subjecting violators of the Bank Secrecy Act to civil penalties, whether inside or outside of the financial institutions. H.R. 1945 would subject a bank and/or its personnel to civil penalties in the amount of the transaction for Bank Secrecy Act violations. Under H.R. 4573, a person who causes a particular violation of the Bank Secrecy Act can be penalized civilly in the amount of the transaction involved. Because both H.R. 1945 and H.R. 4573 amend Title 31 of the United States Code, the criminal penalties found in Section 5322 of Title 31 will not only apply to the bank and its personnel, but also to the person outside the bank. The amended Title 31, along with use of the new forfeiture provisions as set out in H.R. 4573, gives the law enforcement community and financial institutions an effective weapon against two elements of the drug traffic — the person and the proceeds.

In addition to the legislative changes, you requested comment on proposed changes to the Financial Institutions Regulatory and Interest Rate Control Act, particularly Title I, Title VI, and Title XI.

As we have already stated, we do not believe there is any need to amend Title XI, the Right To Financial Privacy Act. Title VI, the Change in Bank Control provisions, has already been discussed in the context of H.R. 3892. We do not believe there is a need to make changes in Title I (Supervisory Powers) or in Title VI (Change of Bank Control) at this time. However, if the Congress and the Supervisory agencies believe changes are necessary to combat drug trafficking, we would be happy to work with Congress and the regulators on any possible changes.

ENDNOTES

[1] See *United States V. Anzalone*, 766 F.2d 676 (1st Cir. 1985), *United States v. Denemark*, 779 F.2d 1559 (11th Cir. 1986) and *United States v. Varbel*, 780 F.2d 758 (9th Cir. 1986) which have all held that structuring currency transactions to avoid the reporting requirements was not a crime. In fact, the court in the *Varbel* case pointed out that:

> [I]f Congress or the Secretary wish to impose a reporting duty on financial institution customers, they must do so in clear, unambiguous language. We cannot impose the duty by implication.

[2] See *United States v. Tobon-Builes*, 709 F.2d 1092 (11th Cir. 1983) and *United States v. Thompson*, 603 F.2d 1200 (5th Cir. 1979).

[3] 781 F.2d 1432 (9th Cir. 1986). Here, an individual employed persons as "runners" who each day carried large sums of currency to various banks and converted the cash into cashier's checks or other negotiable instruments. The currency was apparently derived from cocaine trafficking. The court on the authority of the *Varbel* decision reversed the convictions on the charges of conspiracy to violate Section 5313.

The court concluded that "the currency reporting requirements of 31 U.S.C. 5313 do not apply to multiple transactions, each involving less than $10,000 but aggregating to make more than $10,000." 781 F.2d at 1438.

STATEMENT OF
JEFFREY GLEKEL AND
LAWRENCE B. PEDOWITZ

on behalf of the

ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK

concerning

MONEY LAUNDERING LEGISLATION

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

May 14, 1986

Mr. Chairman and Members of the Subcommittee. I am Chair of the Committee on Federal Legislation of the Association of the Bar of the City of New York. With me is Lawrence B. Pedowitz, a member of the Committee who is the principal author of the Report which the Association has issued concerning money laundering legislation. The Association consists of approximately 15,000 attorneys, most of whom practice in the New York City area.

We appreciate this opportunity to present the Association's views concerning the important but difficult subject of money laundering. Our Report, entitled Money Laundering: An Analysis of Legislative Proposals, represents the culmination of an extensive and exhaustive examination of the issues posed by money laundering legislation. Since we are unable to include all of our analysis and recommendation in our statement, we respectfully request that the full Report be included in the Subcommittee's record.

Of course the views contained in our Report are those of the individual members of the Committee on Federal Legislation and not those of their professional affiliations or clients. Nevertheless, it is relevant to note that the Committee's members brought to their consideration of this problem diverse professional backgrounds and experience. We include government attorneys, former prosecutors, staff member of the American Civil Liberties Union, law professors, and banking lawyers. Despite these different perspectives from which we approached this issue, we arrived at a broad consensus concerning where the balance should be struck between legitimate law enforcement concerns and other important societal interests.

Summary of Conclusions

Money laundering is a growing national problem. Its existence contributes significantly to the vitality and profits of organized crime in the United States, especially to narcotics trafficking. We believe that this Subcommittee is rightly focusing upon money laundering's pervasiveness and its ill effects. We also agree with the Administration and others who believe that new legislation is needed to combat money laundering.

We are concerned, however, that any legislation enacted in response to significant law enforcement interests be narrowly tailored so as not to encroach unnecessarily on other societal interests, such as the protection of individual rights of privacy.

In our view, most of the pending legislative proposals, and in particular H.R. 2785, are overbroad in a number of important respects and cannot be sufficiently justified by law enforcement concerns. We believe that if, after enactment of narrower legislation, experience dictates the need for more expansive legislation, amendments can be proposed.

We principally urge, in summary, that federal legislation in this area should be subject to a number of key restraints. First, we recommend that a federal offense of money laundering be limited to those instances in which the money laundering: (i) is undertaken "knowingly"; (ii) utilizes a bank or other "financial institution"; and (iii) involves the cash proceeds of federal offenses that qualify as "racketeering activity" under the Racketeering Influenced and Corrupt Organizations ("RICO") statute. Second, although we agree that there is some need to liberalize the disclosure provisions of the RFPA, we do not believe there is any justification for permitting voluntary disclosure by financial institutions of customer financial records beyond certain derivative information. We recommend that voluntary disclosure be strictly limited to identifying information concerning the customer and account involved in, and the nature or specifics of, the suspected illegal activity. Third, we recommend against creating a receipt of criminal proceeds offense which would criminalize on a federal level conduct of a much broader scope than we believe desirable.

A. Money Laundering Statute

The need for a money laundering statute seems plain. As the Commission Report makes evident, nothing short of new legislation will "strike directly at the activities in which money launderers engage."[1] Money launderers who comply with the recordkeeping and reporting requirements of the Bank Secrecy Act ("BSA") by completing CTRs and other required forms "can operate with virtual impunity, unless and until it can be proved that the launderer has violated another Federal statute."[2] Moreover, bank officials and employees who know that money laundering is occurring, but nonetheless continue to file the requisite BSA forms, also may escape liability. The BSA poses simply too indirect and ineffective attack on the problem. Some direct prohibition which would apply to financial institutions, and their officers and employees is necessary.

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[1] President's Commission on Organized Crime, The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering 61 (Interim Report to the President and the Attorney General, October 1984) [hereinafter "Commisson Report"]

[2] Id.

Accordingly, a statute -- narrowly designed to address these issues by criminalizing the knowing participation in or facilitation of money laundering schemes -- would appear to be an effective and necessary complement to the existing statutes (*i.e.*, the BSA) available to combat money laundering. By increasing both the amount and likelihood of incurring penalties for money laundering activities, such legislation should act as a more definite deterrent. It would also squarely attack the money laundering problem and serve the dual purposes of striking at organized crime and protecting the integrity of financial institutions.

1. *Mens Rea*.

A very troublesome aspect of the money laundering statutes contained in the legislative proposals is the level of culpability giving rise to criminal liability. The scienter requirement must create a statute that is broad enough to reach those persons actively involved in money laundering, but narrow enough to avoid covering innocent parties.

The "reason to know" standard [3] of H.R. 1367 and to a lesser degree the "reckless disregard" standard of H.R. 2785 are objectionable because they may in practical application, particularly when presented to a jury, give rise to convictions for what is merely negligent conduct. The difficulty is that each standard, either definitionally or through connotations associated with common usage, creates a purely objective basis upon which to convict a defendant, *i.e.*, these standards ask what *should* the defendant have known or done. These standards will thus also create uncertainty among financial institutions and the public at large over what constitutes the offense of money laundering.

These objective standards go well beyond the money laundering problem as defined by the Commission Report and testimony before Congress. Typical money launderers are persons who actually know they are dealing with "dirty money" or have a strong suspicion with regard thereto but deliberately close their eyes in order to avoid confirming that suspicion. Such subjective knowledge is what differentiates the true money launderer from the multitudes of persons engaged in everyday financial transactions who may inadvertently aid in a transfer of illegally acquired funds. The wire transfer of funds or the issuance of a money order, for example, involves the same action by a bank employee whether or not he or she is a money launderer. What makes the bank employee a money launderer is what the employee knows about the funds that he or she is handling.

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[3] Such a standard has few precedents in existing federal criminal statutes. *But see,* Foreign Corrupt Practices Act, 15 U.S.C. § 78dd-2(a)(3).

Accordingly, the scienter requirement should be one that is unmistakably subjective, *i.e.*, the standard should ask what did the defendant actually know. The *mens rea* definition of "knowingly" contained in H.R. 1474, we believe, accomplishes this goal.

Such a standard would not permit the guilty to escape punishment. Moreover, "knowingly" has historically also included a doctrine variously known as "conscious avoidance," "studied ignorance," or "willful blindness," which essentially states that "if a party has his suspicion aroused but then deliberately omits to make further inquiries, because he wishes to remain in ignorance, he is deemed to have knowledge."[4] In other words, knowledge exists where there is a conscious advertence to a risk or a probability that the attendant circumstances exist, followed by a deliberate decision to disregard or not pursue the suspicion, and to act regardless of the attendant circumstances.

The most authoritative statutory effort to codify the "conscious avoidance" doctrine within a definition of "knowledge" is the Model Penal Code. Section 2.02(7) thereof reads as follows:

> Requirement of Knowledge Satisfied by Knowledge of High Probability. When knowledge of the existence of a particular fact is an element of an offense, such knowledge is established if a person is aware of a high probability of its existence, unless he actually believes that it does not exist.[5]

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[4] G. Williams, Criminal Law: The General Part § 57 at 157 (2d ed. 1961).

[5] Model Penal Code § 2.02(7) (Proposed Official Draft 1962). The original draft of this language, published in Model Penal Code (Tent. Draft No. 4, 1955), required awareness only of a "substantial probability" of the fact's existence, instead of a "high probability." According to the most recent commentaries to the Code, the change made in the Official Draft reflected "the view that 'substantial' did not imply a sufficient level of probability and weakened the distinction between knowledge and recklessness as modes of culpability." American Law Institute, Model Penal Code and Commentaries, Part I, § 2.02 at 248 n.42.

The "high probability" Model Penal Code definition of knowledge has received tacit Supreme Court endorsement several times.[6] And on the circuit court level, almost every circuit has explicitly adopted the tenet that "knowledge" includes the notion of "conscious avoidance."[7]

Given this construction of the "knowingly" standard, its use in a money laundering statute will allow prosecution only of those who either know or are consciously aware of a high probability that they are

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[6] *See*, *e.g.*, *Turner* v. *United States*, 396 U.S. 398, 416-17 & n.19 (1970) (approving reference to the "high probability" formulation as a measure of "knowledge" under former 21 U.S.C. § 174 (now § 841)); *Leary* v. *United States*, 395 U.S. 6, 46 n.93 (1969) (Model Penal Code definition used as a "general guide" to determine the scope of the word "knowing" in former 21 U.S.C. § 176(a)); *see also* *Barnes* v. *United States*, 412 U.S. 837, 845 & n.10 (1973) (18 U.S.C. § 1708 construed). *Turner* and *Barnes* also more generally endorse the "conscious avoidance" doctrine outside of the Model Penal Code context, noting that awareness of the attendant circumstances inevitably existed in each case "unless [defendants] practice[d] a studied ignorance to which they are not entitled." *Turner*, 396 U.S. at 417; *Barnes*, 412 U.S. at 845 n.10 (quoting *Turner*).

[7] *See*, *e.g.*, *United States* v. *Wright*, 537 F.2d 1144, 1145 (1st Cir.) ("['knowingly'] scienter requirement can be met when there is a reckless disregard as to the truth of the statements to which one subscribes and when there is a conscious purpose to avoid the truth."), *cert*. *denied*, 429 U.S. 924 (1976); *United States* v. *Cincotta*, 689 F.2d 238, 243 n.2 (1st Cir.) ("[e]vidence of conscious avoidance is merely circumstantial evidence of knowledge"), *cert*. *denied*, 459 U.S. 991 (1982); *United States* v. *Squires*, 440 F.2d 859, 863 (2d Cir. 1971) (court adopts Model Penal Code formulation for purposes of interpreting 18 U.S.C. § 922(a)(6)); *United States* v. *Sarantos*, 455 F.2d 877, 881 (2d Cir. 1972) ("[c]onstruing 'knowingly' in a criminal statute to include willful blindness to the existence of a fact is no radical concept in the law"); *United States* v. *Hanlon*, 548 F.2d 1096, 1101 (2d Cir.

(footnote continued)

participating in a money laundering transaction, and not of those who merely carelessly or unwittingly participate in such transactions.

An additional problem is that, as currently drafted, all three bills are ambiguous concerning the relationship of their applicable *mens rea* standards to their definition of "unlawful activity". Specifically, what in fact must a defendant know to be found guilty?

Each bill is susceptible to being read as requiring government proof that the offender had the requisite *mens rea*

(footnote continued)

1977) ("settled law that a finding of guilty knowledge may not be avoided by a showing that the defendant closed his eyes to what was going on about him"); *United States* v. *Cano*, 702 F.2d 370, 371 (2d Cir. 1983) ("knowledge is established if a person is aware of a high probability of its existence, unless he actually believes that it does not exist") (quoting *United States* v. *Bright*, 517 F.2d 584, 587 (2d Cir. 1975)); *United States* v. *Caminos*, 770 F.2d 361 (3d Cir. 1985) (deliberate closing of eyes to a high probability can constitute knowledge); *United States* v. *Martin*, 773 F.2d 579 (4th Cir. 1985) (knowledge inferrable from willful blindness); *United States* v. *Restrepo-Granda*, 575 F.2d 524, 529 (5th Cir.) (approval of equating deliberate ignorance with knowledge), *cert*. *denied*, 439 U.S. 935 (1978); *United States* v. *Seelig*, 622 F.2d 207, 213 (6th Cir.) (same), *cert*. *denied*, 449 U.S. 869 (1980); *United States* v. *Moser*, 509 F.2d 1089, 1092-93 (7th Cir. 1975) (same); *United States* v. *Massa*, 740 F.2d 629, 643 (8th Cir. 1984) (jury may "infer the element of knowledge from deliberate indifference"), *cert*. *denied*, 105 S. Ct. 2357 (1985); *United States* v. *Jewell*, 532 F.2d 697, 700 (9th Cir.) (en banc) ("to act 'knowingly' . . . is . . . also to act with an awareness of the high probability of the existence of the fact in question"), *cert*. *denied*, 426 U.S. 951 (1976); *United States* v. *McAllister*, 747 F.2d 1273, 1275 (9th Cir. 1984) (same), *cert*. *denied*, 106 S. Ct. 92 (1985); *Griego* v. *United States*, 298 F.2d 845, 849 (10th Cir. 1962) ("a conscious purpose to avoid enlightenment" is tantamount to "knowledge").

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with regard to the fact that the unlawful activity in question, either under H.R. 1474 and H.R. 1367, constituted a RICO-type offense, or under H.R. 2785, constituted a felony. If the mens rea level includes "reckless disregard," this extra step of proof is not much of an obstacle and probably can be inferred circumstantially. But if "knowledge" must be shown (as is argued herein), a spurious defense is created to the effect that the defendant might have known that the laundered funds derived from illegal activity, but not from illegal activity that constitutes a RICO-type offense.

Although arguably this type of hypothetical defendant might be viewed as slightly less culpable than one with more specific knowledge of the exact nature of the underlying illegal activity, we believe that the federal interest in eradicating money laundering is sufficiently strong so as not to require that this distinction be drawn. A person who is in fact laundering drug-related monies, but who thinks the funds derive from a bank robbery, should still be included within the bill's scope, since his or her contribution to the continued existence of drug money laundering is the same as someone with more accurate knowledge, and his or her level of culpability is still sufficiently high to deserve criminal conviction.[8]

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[8] Cf. United States v. Feola, 420 U.S. 671 (1975) (it is no defense to the crime of assaulting a federal officer, see 18 U.S.C. § 1114, that the defendant did not know the victim was a federal officer).

Accordingly, we are of the view that any bill should explicitly provide that *no mens rea* component attaches to the element of the money laundering offense requiring that the laundered funds be derived from a specific type of illegal activity. Knowledge that the funds derive from *any* illegal activity, if *in fact* they do derive from an illegal activity constituting an offense covered by the statute, should suffice for criminal culpability under the bill.[9]

The easiest and least obtrusive method for accomplishing this result might be simply to substitute for "any unlawful activity" wherever it appears in the bills the phrase "any illegal activity that is in fact unlawful," with "unlawful" being defined as an act or activity constituting the type of offense sought to be covered, *e.g.*, a RICO-type offense. The legislative history to the bill should then provide that the words "in fact" mean that no scienter is necessary with respect to the unlawful element. Alternatively, the bill could simply include a sentence to the effect that "where knowledge of the illegal nature of the activity generating the monetary instruments or funds exists, it shall be no defense hereunder to plead lack of knowledge that such activity constitutes an 'unlawful activity' as defined herein."

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[9] *See generally United States* v. *Freed*, 401 U.S. 601, 614-16 (1971) (Brennan, J., concurring in judgment) (discussing the crime of possession of unregistered hand grenades and concluding that knowledge is required as to the facts of possession and of the weapons being hand grenades, but not as to their unregistered status; stating also that such *mens rea* analysis is controlled solely by congressional intent).

2. Financial Transaction.

The money laundering offense defined in H.R. 2785 covers virtually any transfer of funds by means of cash, check, money order, bearer security or other negotiable instrument. It does not require the involvement of a commercial bank, savings and loan association, brokerage firm or other financial institution. As a result, cash transactions with anyone from grocery stores to law firms to sellers of homes may now be the subject of this criminal statute. Coupled with its nebulous mens rea standard, this definition of transaction renders H.R. 2785 dangerously broad in scope.

The history of the money laundering problem suggests that there is no need to extend the scope of the offense beyond transactons by or through "financial institutions." In the Commission Report, virtually all of the case studies presented to illustrate the extent of the money laundering problem involve financial institutions (i.e., banks, brokerage firms and foreign currency dealers). The Report specifically identifies "[d]enying organized crime access to the financial institutions of this country" as a "crucial component" in the fight against money laundering and drug trafficking.[10] The only historical exceptions to the use of financial institutions to launder money are casinos and the Hells Angels' acquisition of real estate and certain "failing" businesses.[11]

In light of these facts, we believe that if the covered transactions were limited to those with financial institutions, the effectiveness of the statute would not be materially diminished. "Financial institution" is already defined in all three bills to mean an institution defined in the BSA. The courts have interpreted this definition broadly to mean any enterprise, legitimate or not, or person engaged in the exchange of currency for profit.[12]

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[10] Commission Report, at 4. Testimony by law enforcement officials before Congress confirms the fact that financial institutions invariably are the essential link in the money laundering chain. According to the testimony of Roscoe Egger, at that time Commissioner of the Internal Revenue Service, "the objective of money laundering is to convert proceeds from questionable sources into money that can be used without question. This transformation is essential not only for spending money, but also for transporting it, since the sheer bulk of currency may cause difficulty. The use of financial institutions is essential to this process." September 12, 1985 hearing before Subcommittee on Oversight, Committee on Ways and Means.

[11] Commission Report, at 10-11.

[12] See United States v. Goldberg, 756 F.2d 949 (2d Cir.), cert. denied, 105 S. Ct. 2706 (1985). In Goldberg, officers of two banks and an employee of a gasoline wholesaler accepted $200,000 in currency in exchange for a bank check in an alleged scheme to aid a third party in opening a foreign bank account without triggering any of the reporting requirements. The Second Circuit ruled that the individuals, acting together, were a "financial institution" for purposes of the BSA. Id. at 955.

Moreover, the Secretary of the Treasury has the authority to expand the definition of "financial institution."[13] Indeed, one of the Commission Report's recommendations -- to include, pursuant to regulatory authority, "casino" in the BSA definition of "financial institution" -- has been accomplished by adoption of regulations.[14]

Given this broad meaning of "financial institution", and the government's ability to expand upon it when necessary, the money laundering statute could be limited to transactions with financial institutions without hindering the government's ability to prosecute significant money launderers. Otherwise, a grocery store clerk who takes a $50 bill from a reputed crime figure for groceries -- knowing the $50 is the fruit of a crime -- would be prosecutable as a felon.

One way to address this problem would be to fix a minimum monetary amount which must be satisfied before a transaction would be considered within the scope of a money laundering statute. This would remove the grocer and some other nonfinancial institutions from the reach of the statute. Depending upon the threshold amount chosen, however, other persons ranging from lawyers and doctors to sellers of homes would still be subject to criminal liability.[15] Persons who engage in what might be considered a one-time transaction with a felon for goods or services -- even if the person knows that he is dealing with a criminal -- have not been identified as seriously contributing to the money laundering problem and therefore should not be subject to the criminal statute, regardless of the size of the transaction. The money laundering statute should instead concentrate upon persons who are engaged in the business of exchanging currency for profit.[16]

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[13] 31 U.S.C. § 5312(a)(2)(U).

[14] Compare Commission Report, at 58, with 50 Fed. Reg. 5065 (1985).

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[15] Including criminal defense lawyers within the scope of the statute raises serious risks of impinging upon a criminal defendant's Sixth Amendment rights. The payment of a retainer by a defendant in a criminal action to his attorney might easily render the attorney a money launderer (or at least susceptible to prosecution) under the Administration's bill. Obviously, this would limit many defendants' abilities to retain counsel.

A similar but less egregious problem has arisen under the forfeiture provisions of the Comprehensive Forfeiture Act of 1984, Pub. L. No. 98-473, Title II, §§ 301-322, 98 Stat. 2040 ("Forfeiture Act"), some federal courts have ruled that the forfeiture of attorneys' fees would effectively deter any attorney from representing a criminal defendant and thereby violate the defendant's Sixth Amendment rights. See, e.g., United States v. Badalamenti, 614 F. Supp. 194 (S.D.N.Y. 1985). Here, not only would the fee be subject to forfeiture (at least under the forfeiture provisions of § 9 of H.R. 2786, if not under the Forfeiture Act), but the defense lawyer may also be found criminally liable.

Although the potential clearly exists for attorneys actually to launder funds (through, for example, padded fees and kickbacks), this has not been identified by law enforcement officials as a typical or significant means of money laundering. Given the obvious risk to a defendant's Sixth Amendment rights, the inclusion of criminal defense attorneys under the statute by defining "transaction" broadly does not appear warranted.

(footnote continued)

An additional problem with H.R. 2785's formulation of "transaction" is that it may unnecessarily and inappropriately transform certain state crimes into federal crimes.

(footnote continued)

Existing criminal laws, in particular the aiding and abetting statute and the existing forfeiture laws, suffice as tools for law enforcement officials to prosecute attorneys who launder significant amounts of money for criminals. A limitation in the bill to transactions with financial institutions would ameliorate this problem.

For these same reasons, the new crime contained in H.R. 2785 of receiving the proceeds of a federal felony seriously threatens Sixth Amendment rights of defendants.

[16] Other deterrents already exist for grocers, doctors, home sellers and others who knowingly transact business with a criminal. The federal government presently has the ability to forfeit the proceeds of a crime even in the hands of a transferee who is a bona fide purchaser for value if such transferee had cause to believe such proceeds were derived from a crime. 18 U.S.C. § 1963(c); 21 U.S.C. § 853(c). These forfeiture provisions are "intended to dissuade the commercial world from dealing with racketeers and traffickers, warning that one who accepts dirty money in payment for goods or services may forfeit it." United States v. Badalamenti, 614 F. Supp. 194, 196 (S.D.N.Y. 1985). Thus, the grocer mentioned above would have to give up his $50. This seems to be a more reasonable deterrent than imposing criminal liability on the grocer. In most cases, such forfeiture provisions should eliminate the need to cover monetary transactions in the money laundering statute which are not covered by the already broadly defined term "financial institution."

Specifically, any crime involving the transfer of a monetary instrument could be considered a money laundering "transaction." A theft, a robbery, a check forgery -- giving rise to crimes traditionally prosecuted at the state level -- would become federal money laundering offenses. This effect has the potential not only to dissipate limited federal resources, but also to create friction between federal and state authorities.

The other legislative proposals, H.R. 1474 and H.R. 1367, require that the money laundering transaction involve a financial institution. We believe that this approach is clearly preferable.

3. Unlawful Activity.

"Unlawful activity" under the Administration's bill, H.R. 2785, means any act occurring in whole or in part in the United States which is a felony under federal or state law. H.R. 1474 limits the criminal offenses from which laundered money may be derived to "racketeering activity" as defined under RICO. H.R. 1367 limits the "unlawful activity" to selected RICO offenses, omitting state law RICO predicate acts and securities law violations.

A primary issue in defining "unlawful activity" is deciding whether it should include state law offenses. To the extent money laundering in and of itself is perceived as a national problem, the inclusion of state law offenses may be warranted. According to the Commission Report and testimony before Congress, however, money laundering is encouraging particular federal crimes, principally drug trafficking. Money laundering has not been presented as an impetus to particular state crimes which are not also federal crimes. We recommend at this juncture, therefore, that Congress cover only those crimes identified as benefitting significantly from money laundering.

It may be that the inclusion of state offenses as predicate crimes under the money laundering statute will be warranted in the future. It is conceivable, for example, that the federal government would have a particular interest in prosecuting someone who laundered money in New York for a Connecticut robbery ring.

We perceive several risks, however, in the inclusion of state law offenses as predicates. One, this will federalize what are traditionally state law crimes, thereby expanding the reaches of federal law and federal law enforcement investigative jurisdiction. Secondly, it will create confusion by merging certain state law offenses with the money laundering crime. For example, a theft or a check forgery -- traditionally giving rise to state crimes -- may themselves constitute financial transactions which amount to the federal crime of money laundering. Thus, as the Administration's bill is drafted, an "unlawful activity" (such as passing a forged check) could also constitute a money laundering transaction, and therefore a defendant could be charged with the federal crime of money laundering and the state law crime of forgery for precisely the same act.

Accordingly, we endorse H.R. 1367's definition of "unlawful activity," which by including "racketeering activities" as generally defined under RICO but not including state law RICO offenses or securities law violations, appears best suited to resolve these issues. It may be, however, that Congress will wish to tighten further H.R. 1367's definition of "unlawful activity" by exploring whether each of the federal offenses included has been sufficiently identified as a crime that benefits significantly from money laundering.

4. Extraterritorial Application.

International money laundering is a significant problem for United States law enforcement officials. According to the Commission, $5 to $15 billion of the $50 to $75 billion in illegal drug money earned annually in the United States moves into international financial channels.[17] Recognizing this problem, each of the bills under consideration provides for extraterritorial jurisdiction.

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[17] Commission Report at 13.

Whereas H.R. 1367 simply provides that "there is extraterritorial jurisdiction over the conduct prohibited by this section," (and H.R. 1474's language is virtually identical), the Administration's proposal, H.R. 2785, establishes four criteria for extraterritorial jurisdiction. See supra pp. 30-31.

One of the H.R. 2785's requirements -- that a United States person be involved or that at least part of the transaction occur in the United States -- plainly satisfies constitutional requirements for the exercise of extraterritorial jurisdiction by United States law enforcement officials.[18] Although courts could read such jurisdictional predicates into any legislation that purports to grant extraterritorial jurisdiction (or even legislation that does not)[19] our preference is for a statute that is explicit at the outset in its coverage. Accordingly, we endorse this aspect of H.R. 2785's extraterritorial treatment.

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[18] See generally Restatement (Second) of Foreign Relations Law § 402(1) & (2) (Tent. Draft No. 2, 1981) (specifying the bases for extraterritorial jurisdiction); see also United States v. Bowman, 260 U.S. 94, 98 (1922); United States v. Pizzarusso, 388 F.2d 8, 10 (2d Cir.), cert. denied, 392 U.S. 936 (1968). Indeed, in certain instances, it is constitutionally acceptable to extend extraterritorial reach to acts by aliens occurring wholly without the United States. See Restatement (Second) of Foreign Relations Law §402(3) & Comment (d) (Tent. Draft No. 2, 1981); United States v. Pizzarusso, 388 F.2d 8 (2d Cir.), cert. denied, 392 U.S. 936 (1968) (alien in foreign U.S. consulate knowingly making false statement under oath in visa application); Rocha v. United States, 288 F.2d 545 (9th Cir.) (same), cert. denied, 366 U.S. 948 (1961); United States v. Zehe, 601 F. Supp. 196 (D. Mass. 1985) (Espionage Act applied to non-citizen abroad).

The three remaining criteria under the Administration's bill, however, create a differentiation between domestic and international transactions that does not appear to have any sound basis. First, the explanatory commentary to H.R. 2785 offers no reason for the bill's contraction of the "unlawful activity" definition in its extraterritoriality section from the broader domestic counterpart encompassing all federal felonies. We support the notion of narrowing the definition of "unlawful activity," but feel that it should be done across the board, so that the same definition applies both domestically and internationally. However, "unlawful activity" might justifiably be expanded for extraterritorial application to include violations of foreign drug trafficking laws.

Second, the explanatory commentary to H.R. 2785 explains the contraction of the scienter requirement in the bill's extraterritoriality section, *i.e.*, the deletion of the

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[19] *See, e.g.*, *United States* v. *Bowman*, 260 U.S. 94, 98 (1922); *United States* v. *Birch*, 470 F.2d 808, 810-12 (4th Cir. 1972), *cert. denied*, 411 U.S. 931 (1973).

"reckless disregard" component that is in the domestic definition, as resulting from the belief that the law should not impose "a duty on a United States or foreign person acting abroad to become aware of United States laws." Although we agree with the ultimate result, namely that extraterritorial application of the statute should be based on a scienter level of "knowledge" only, this is based on our belief that the domestic mens rea standard should be limited to "knowledge." The Administration's explanation not only creates a different statute for foreign operation, but suggests that for a foreign person or United States person abroad, ignorance of the law will be a defense -- a proposition we believe should be rejected.

Third, for the same reasons discussed earlier, we do not support requiring a minimum $10,000 transaction for an offense to exist. The dangers of an overreaching statute are better met by limiting the type of financial transactions and unlawful activities that constitute an offense.

B. RFPA Amendments

The RFPA currently is being read by financial institutions as proscribing voluntary disclosure beyond a relatively meaningless statement that they have information which may be relevant to a violation of law. State common law theories of privacy and implied warranties of confidentiality, too, have resulted in prohibitions against voluntary disclosures. The need for amendments to the RFPA appears evident.

The more difficult question is what should be the scope of such amendments, and more specifically from a policy perspective, what balance should be struck between facilitating law enforcement activities on the one hand and preserving legitimate customer expectations of privacy on the other?

1. Extent and Type of Information Permitted in Voluntary Disclosures.

The Committee's view is that the findings of the Commission Report clearly justify some liberalization of the present statute. Specifically, the Committee believes that the RFPA should be amended to provide that financial institutions, and their officers, employees and agents, may disclose not only "information that may be relevant to a possible [law] violation," as under the present statute, but in addition the identity of the particular customers and accounts that are involved in the "possible violation" to which the information disclosed may be relevant.

To this end, we endorse the approach utilized by H.R. 1367 in amending § 1103(c) of the RFPA by: (i) inserting the words "it believes" prior to the phrase "may be relevant";

and (ii) adding the phrase "and thereafter disclosing such information to that government authority, regardless of whether a subpoena, summons, search warrant or formal written request has been issued under the provisions of this chapter."[20] Both of these changes explicitly and plainly clarify that volunteerism is contemplated by the RFPA.

H.R. 2785's approach, which is to add a new paragraph (l) to § 1113 of the RFPA, accomplishes the same result, but by making the entire RFPA inapplicable to voluntary disclosures -- a method which seems unnecessarily sweeping.

Adopting H.R. 1367's approach without more, however, leaves in unsatisfactory condition the extent and type of information that is voluntarily disclosable. The apposite standard for voluntary disclosure would become "such information" that the financial institution "believes may be relevant to a possible [law] violation," and in conjunction with the proposed language of H.R. 1367's extended good-faith defense, this standard would appear to allow extensive voluntary disclosure of the "financial records" of a customer. H.R. 2785's approach plainly would allow such disclosure.

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[20] Amended § 1103(c) would thus read:

> (c) Nothing in this chapter shall preclude any financial institution, or any officer, employee, or agent of a financial institution, from notifying a Government authority that such institution, or officer, employee, or agent has information which it believes may be relevant to a possible violation of any statute or regulation, and thereafter disclosing such information to that Government authority, regardless of whether a subpoena, summons, search warrant, or formal written request has been issued under the provisions of this chapter. [Underlining represents H.R. 1367's changes.]

The Committee believes that this amount of voluntary disclosure goes too far. Indeed, the Commission Report appears to contemplate only sufficient disclosure to place the scent of wrongdoing in the government's nose.[21] Thus, while we recognize the need to permit voluntary disclosure to include identifying information concerning the individuals and accounts involved in, and the nature and specifics of the suspected illegal activity, we believe voluntary disclosure should not otherwise extend to revealing a customer's financial records, or information derived therefrom.

Accordingly, we endorse the appending of limiting language to § 1103 (c) along the lines of: "Such information may only include the name and names of, and other identifying information concerning, the individuals and accounts involved in, and the nature and specifics of, the suspected illegal activity. It may not otherwise include financial records or information identified with or identifiable as being derived from the financial records of a particular customer."[22]

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[21] Commission Report, at 59.

These same concerns also necessitate that any extension to voluntary disclosure situations of § 1117(c)'s good-faith defense be drafted to coordinate precisely with the amount of voluntary disclosure an amended § 1103(c) will allow.[23]

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[22] This language is roughly identical to language proposed to be added to § 1103(c) by H.R. 2785. *See* H.R. 2785 § 3(b). Three changes, however, significantly alter this language from that proposed in H.R. 2785. The first is the inclusion of the word "only" before "include." Whereas H.R. 2785's proposed language is intended to be explanatory of the information the voluntary disclosure may include, ours is intended to be exclusive, setting a limit to the amount of information contained in a voluntary disclosure. To drive this point home, the second change is the addition of a final sentence explicitly specifying that the disclosure may not otherwise include a customer's financial records, or information derived therefrom. The final change is the inclusion of the words "and specifics" between the words "the nature" and "of the posssible law violation." This alteration is intended to clarify that the financial institution is permitted to reveal details in its possession concerning the activities that constitute the suspected illegal activity.

[23] Additionally, the changes outlined here might benefit from greater explicitness in the RFPA's definition of "financial record," clarifying that because "financial record" also includes information derived from financial records, both: (i) identifying customer and account information and (ii) specifics of suspected illegal activity (to the extent a transaction with the financial institution has been completed), are technically "financial records" not subject to voluntary disclosure *except* as specifically authorized elsewhere.

C. The New Receiving Crime

The Administration's proposal, H.R. 2785, § 8, would add to Title 18 a new § 2322 defining a felony called "Receiving the Proceeds of a Crime." No other bill contains this proposed new crime.

The crime actually consists of two separate offenses, the first of which applies to whoever "receives" money or property obtained in connection with "a violation of any law of the United States" that is punishable as a felony, "knowing or believing" it to have been so obtained, and the second of which applies to whoever "brings or transfers" into the United States money or property obtained in connection with a violation of "any [drug trafficking] law of a foreign country, . . . knowing or believing" it to have been so obtained.

With regard to the first proposed offense defined by new § 2322, we believe that there is no evidence that begins to justify its adoption. The Commission Report nowhere even remotely suggests that this type of broadly drawn response is necessary or even desirable to deal with the problem of money laundering.

Moreover, the breadth of the proposal creates the same sorts of problems discussed in connection with the new money laundering crime proposed by H.R. 2785, including particularly the Sixth Amendment problems associated with its applicability to criminal defense lawyers. Specifically, the actus reus and mens rea components of the crime are so minimal that a likely result will be to bring within its reach criminal lawyers, merchants, and others who merely provide criminal defendants with goods and services. A grocer who sells a can of tuna fish to a person under indictment for being a member of a RICO organization, for example, would appear to risk committing the offense defined by the first part of new § 2322. In this sense, a "status" crime is created, whereby any person with a reputation for being connected to organized crime may be effectively isolated from completing ordinary, day-to-day, financial transactions because the other party will fear incurring "receipt of criminal proceeds" liability.

The second offense defined by new § 2322 does not give rise to these same objections and, indeed, with certain modifications, appears to be an appropriate proposal. The Commission Report quantifies the international dimension of the drug trafficking problem, and there is no valid reason why the United States should allow itself to become a repository for drug-tainted foreign investment. Indeed, to the extent that providing a haven for such funds encourages and facilitates the operations of foreign drug traffickers, there can be little doubt that this undermines efforts to combat drug trafficking within the United States. Moreover, to the extent that one effect of the new money laundering statute may be to drive money laundering activities offshore, the importation of laundered money by narcotics traffickers is a problem that is only likely to increase with time.

Notwithstanding the foregoing, as currently written, the second offense defined by § 2322 is simultaneously both over- and under-inclusive. The primary difficulties are at least twofold, but each may be easily remedied.

First, the crime is limited to "whoever . . . brings or transfers" into the United States such illegally-derived assets. This language should be expanded to cover "whoever . . . brings or transfers or causes to be brought or transferred." It is likely that many of the transfers of funds one would hope to stop with legislation of this sort would be effected not by drug traffickers themselves, but by financial institutions acting on their behalf. The bill should reach foreign drug traffickers who insulate themselves by using intermediaries to "cause" transfers to be made.

Second, for the same reasons discussed in connection with the money laundering crime, the mens rea requirement of "knowing or believing" is too broad. It should be limited to "knowing" transfers, so as not to create a statute too inclusive in its scope.

Finally, although the international nature of the drug trafficking industry creates a strong and substantial federal interest in being able to prosecute all foreign-based parties who aid drug traffickers to invest their profits in the United States, as a practical matter, it may be extremely difficult to reach and prosecute foreign financial institutions that facilitate this process, even if they do so knowingly. Congress may thus wish to consider, given such practical difficulties, whether the offense ought to be restricted to those persons or entities that have actually violated foreign narcotics laws.

An alternative -- and our preference -- to defining and fine tuning a "transferring" offense in a new § 2322, however, is to revise slightly the extraterritoriality provision of H.R. 2786's money laundering statute, proposed § 1956(f). Principally, what appears needed is to extend the list of predicate unlawful activities contained in (f)(1), which currently includes violations of Title 18, criminal violations of the Internal Revenue Code, drug trafficking offenses listed in Title 21, and violations of one of several espionage-type statutes, to include violations of foreign drug-trafficking laws.[24]

Conclusion

We agree with the findings of the Commission Report concerning the extent and scope of the money laundering problem. Money laundering today is a widespread and sophisticated process that contributes greatly to the success of organized criminal activities, especially narcotics trafficking. Current law enforcement tools are inadequate to redress the situation, and new legislation is needed.

However, we believe that the bills that have emerged in response to these concerns, in particular H.R. 2785 but also H.R. 1367, are too broad in their reach and infringe unnecessarily on other, substantial, societal values. Accordingly, we have recommended a number of ways in which to narrow the scope of the bills in an effort to address effectively only those law enforcement problems that clearly exist.

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[24] The extent to which (f)(1) should cover anything other than strictly drug-related offenses is a separate question which we have addressed above and expressed our preference for the approach adopted by H.R. 1474.

MONEY LAUNDERING:
AN ANALYSIS OF LEGISLATIVE PROPOSALS

BY THE COMMITTEE ON FEDERAL LEGISLATION
THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

March 1986 (Revised)

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Introduction

Money laundering is a growing national problem. Its existence contributes significantly to the vitality and profits of organized crime in the United States, especially to narcotics trafficking. Attention has been focused on money laundering's pervasiveness and its ill effects by the recent Interim Report to the President and the Attorney General issued by the President's Commission on Organized Crime in October 1984.

In response, a number of "money laundering" bills have been introduced in Congress. Three appear to be the principal focus of congressional attention: H.R. 1367, introduced by Representative McCollum; H.R. 1474, introduced by Representative Hughes; and H.R. 2786, introduced by Representative St. Germain on behalf of the Reagan Administration. All three bills propose, *inter alia*, to add to Title 18 of the United States Code a new § 1956 for the first time making money laundering a federal crime. Two of the bills, H.R. 1367 and H.R. 2786, also propose amendments to the Right to Financial Privacy Act ("RFPA"),[1] intended to facilitate the reporting by financial institutions to law enforcement officials of suspicious financial transactions. H.R. 2786 additionally would add a new § 2322 to Title 18, making the receipt of criminal proceeds a new federal criminal offense.

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[1] 12 U.S.C. §§ 3401-3422.

This Report is intended to identify and comment on substantive issues raised by these three bills. More specifically, we will examine the Commission Report's findings concerning the scope of the money laundering problem -- which findings we believe to be thoroughly documented -- and then analyze the bills from the perspective of how well they address and remedy the particular problems identified by the Commission. We are concerned that any legislation enacted in response to the Commission Report's identification of law enforcement interests be narrowly tailored so as not to encroach unnecessarily on other societal interests, such as the protection of individual rights of privacy.

We agree with the Commission that new legislation is needed to combat money laundering. As presently drafted, however, we find each of the bills, and in particular H.R. 2786, to be in a number of important respects overbroad, and we express herein a desire for narrower legislation. We believe that if, after enactment of a narrower bill, experience dictates the need for more expansive legislation, amendments can be proposed.

As will be explained herein, it is our conclusion that federal legislation in this area should be subject to a number of key restraints. First, we recommend that a federal offense of money laundering be limited to those instances in which the money laundering: (i) is undertaken "knowingly"; (ii) utilizes a bank or other "financial institution"; and (iii) involves the cash proceeds of federal offenses that qualify as "racketeering activity" under the Racketeering Influenced and Corrupt Organizations ("RICO") statute.[2] Second, although we agree that there is some need to liberalize the disclosure provisions of the RFPA, we do not believe there is any justification for permitting voluntary disclosure by financial institutions of customer financial records beyond certain minimal derivative information. We recommend that voluntary disclosure be strictly limited to identifying information concerning the customer and account involved in, and the nature or specifics of, the suspected illegal activity. Third, we recommend against creating a receipt of criminal proceeds offense which would criminalize on a federal level conduct of a much broader scope than we believe desirable.

This Report consists of five sections. The first three sections focus upon the Commission Report. Section I briefly discusses the scope of the money laundering problem.

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[2] 18 U.S.C. §§ 1961-1968.

Section II identifies the current tools used to combat money laundering and details weaknesses and shortcomings in these tools. Section III outlines the Commission's recommended solutions to the problems it has identified, with particular emphasis on the Commission's legislative proposals. With this material as background, the next sections, IV and V, focus specifically on the three bills currently pending before Congress. Specifically, Section IV summarizes and compares the salient features of each bill and identifies what we view as the important issues raised by their varying approaches. Section V then addresses and analyzes these issues, expressing the Committee's views concerning the appropriate components of a money laundering bill.

I.

Scope of the Money Laundering Problem

The Commission Report, entitled The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering, identifies money laundering -- or the process by which one conceals the existence, illegal source, or illegal application of income and then disguises that income to make it appear legitimate -- as a substantial and growing impediment to the effort to combat organized crime. The Report finds that "money laundering plays a vital role in furthering the activities of organized crime,"[3] and that to the extent the laundering process can be successfully impeded by "[d]enying organized crime access to the financial institutions of this country . . . irreparable damage to the operations of organized crime" will follow.[4]

The Report utilizes a number of case histories of actual money laundering in order to illustrate the scope of the money laundering problem. Money laundering techniques range from the very simple example of a narcotics trafficker who increases the portability of his illegal cash receipts by exchanging numerous smaller-denomination bills for a lesser number of large-denomination bills, to the very complex example of a large organization using false documentation and multiple domestic and international transfers of funds to and from fictitious entities.[5]

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[3] President's Commission on Organized Crime, The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering 4 (Interim Report to the President and the Attorney General, October 1984) [hereinafter "Commission Report"].

[4] Id. at 4, 63.

The net result is a problem whose scope the Commission finds (and we agree) to be "enormous."[6] While the exact amount of money laundered each year is not capable of any precise calculation, the Executive Director and Chief Counsel of the Commission, James D. Harmon, Jr., has suggested that the amount laundered annually from narcotics and other illegal activities totals tens of billions of dollars.[7]

The Commission specifically identifies a central focus of its concern as "the abuse of domestic financial institutions as conduits for the movement of cash or its equivalent generated through illegal narcotics trafficking."[8] A select fraternity of money laundering professionals, accomplished in the details of financial transactions, "uses banks and other financial institutions as routinely, if not

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5. Id. at 8.

6. Id.

7. Statement before the Subcommittee on Crime of the House Committee on the Judiciary, at 4, July 24, 1985.

8. Commission Report, supra note 3, at 5. Although loansharking and gambling play an "appreciable" role, it is narcotics trafficking which "create[s] by far the greatest demand for money laundering schemes." Id. at 7.

as frequently, as legitimate businesses."[9] Deliberate indifference to suspicious transactions by such institutions' officials or employees often compounds the problem.[10]

Thus, the Commission finds (and we concur) that an attack on money laundering can be viewed as serving two goals: a primary one of impeding the activities of organized crime; and a secondary one of protecting banks and other financial institutions from the damage to reputation, morale and efficient functioning that comes from association with money launderers.

II.

Current Techniques for Combatting Money Laundering (and Weaknesses Therein)

The Commission Report discusses in detail the techniques available for combatting money laundering. Money laundering activities currently are detected and prosecuted primarily as violations of the Bank Secrecy Act ("BSA").[11] The BSA provides law enforcement agencies with several basic tools to investigate money laundering:

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[9] Id. at 8.

[10] Id. at 3, 30.

[11] 31 U.S.C. §§ 5311-5322.

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i) A Currency Transaction Report ("CTR") that must be filed by banks and other financial institutions whenever a currency transaction exceeds $10,000.

ii) A Currency or Monetary Instruments Report ("CMIR") that is required whenever currency or monetary instruments exceeding $5,000 are taken into or out of the United States.

iii) A Foreign Bank Account Report ("FBAR") required whenever a person has an account in a foreign bank exceeding $5,000 in value.

Criminal penalties for violations of the BSA are felonies punishable by imprisonment for up to 5 years.[12] Civil monetary penalties can reach $10,000.[13]

The Treasury Department, using the BSA, has in recent years successfully investigated and prosecuted numerous large money laundering operations.[14] Law enforcement activity over the last three years has been even greater, as financial institutions have improved their compliance with the BSA by making prompt CTR and CMIR filings, and the government has devoted additional resources to investigating these transactions.[15] During the 18-month period from 1983 to mid-1984 alone, BSA prosecutions have led to over 1000 indictments and about 400 convictions. This number of indictments exceeds the total number of individuals indicted for BSA violations during the previous ten years.[16]

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[12] 31 U.S.C. § 5322, as amended, see 98 Stat. 2135.

[13] 31 U.S.C. § 5321, as amended, see 98 Stat. 2135.

[14] Commission Report, supra note 3, at 26-27, 42-43.

Although the BSA has been effective as a tool in detecting and halting money laundering operations, the Commission Report documents a number of substantial difficulties in relying solely on the BSA to combat money laundering:

A. The money launderer is subjected to financial penalties or imprisonment only if he or she willfully violates the BSA. As a result, "[t]he money launderer who complies with the recordkeeping and reporting requirements of the [BSA] . . . as money launderers have frequently done in the past, can operate with virtual impunity, unless and until it can be proved that the launderer has violated another Federal statute."[17] Although the money launderer who files the requisite CTRs and CMIRs runs the risk of drawing attention to the sources and/or unreported status of his or her illegal income, many money launderers are willing to make the requisite filings because the reports being filed annually are so numerous that there is a justified belief that the government is not likely to find the "needle in the haystack" that represents criminal proceeds or unreported income. As the Commission Report notes, "[t]oday . . . the amount of information available from CTRs and CMIRs is so great that it poses a challenge to the effective use of that information."[18]

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[15] Id. at 23.

[16] Id. at 26-27.

[17] Id. at 61.

The BSA also fails to track certain financial transactions which pose potential for money laundering. Transactions under $10,000, transactions undertaken by a person or entity exempted from the BSA's requirements, domestic transactions using wire or written orders of transfer, and foreign transactions using cashier's checks or bearer bonds made out to cash, generally fall outside the coverage of the BSA's reporting requirements and thereby create a window of opportunity for money launderers.[19]

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[18] Id. at 9. In 1983 alone, more than 500,000 CTRs, recording the flow of over $20 billion, and about 200,000 CMIRs, recording the flow of over $22 billion, were filed. Id.

[19] Id. at 9, 21, 52. In addition, recent appellate decisions hold that non-reporting of "structured transactions," in which the launderer separates one large cash transaction into several transactions, each involving amounts less than $10,000, expose neither the launderer nor the financial institution to liability under the BSA or other criminal law. See United States v. Denemark, No. 85-3154 (11th Cir. Jan. 16, 1986); United States v. Varbel, No. 84-1231 (9th Cir. Jan. 10, 1986).

B. So as long as the BSA's filing requirements are met, the Act provides neither civil nor criminal penalties for financial institutions that otherwise facilitate money laundering transactions. Accordingly, employees and officials of financial institutions that know or are deliberately indifferent to the fact that money launderers are using their facilities generally have no legal obligation to notify authorities and run little risk of incurring substantive liability for turning a blind eye to suspicious transactions.[20] In the absence of such liability, considerations of customer privacy or even of mere convenience typically render financial institutions unwilling to examine financial transactions closely for clear evidence of illegal laundering activity and to report their findings.[21] As a result, the one element identified by the Commission as increasingly essential to the success of much modern day money laundering -- the availability of sophisticated financial machinery -- is in no way denied to would-be money launderers.[22]

Although the three bills under consideration do not agree precisely on what acts and scienter levels should serve to expose financial institutions to liability for facilitating money laundering, they do reflect general agreement with the Commission Report that some direct prohibition aimed at the financial institutions is necessary. Because the BSA's sole demand upon financial institutions is compliance with its filing requirements, the BSA poses simply too indirect and ineffective an attack on the problem.

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[20] Id. at 3, 30, 61.

[21] Id. at 30.

[22] Id. at 3-8.

C. Given the huge amount of profits to be made from money laundering and illegal activities it facilitates, the civil and criminal penalties established by the BSA provide an inadequate deterrent to money launderers.[23] Moreover, the BSA penalties fail to address separately (or adequately) those instances in which the money launderer has obtained, or attempted to obtain, the active collusion of the financial institution. While a slightly augmented penalty is possible if the bribery of bank official provisions of sections 215 and 216 of Title 18 are invoked,[24] these sanctions are still inadequate to deter the money launderer.[25]

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[23] Id. at 27, 52. Subsequent to issuance of the Commission Report, the penalties established by the BSA were increased substantially pursuant to the Comprehensive Crime Control Act of 1984. See 98 Stat. 2135.

[24] Id. at 29-30, 52. Subsequent to the issuance of the Commission Report, 18 U.S.C. § 216 has been repealed, and § 215 revised. See infra note 42.

[25] Moreover, the BSA fails in a more general sense to provide the necessary techniques and resources to deal

(footnote continued)

D. Successful employment of the BSA as a money laundering detection and prosecutorial instrument depends importantly on the active cooperation of the financial institutions involved, not merely in terms of making accurate, complete, and prompt filings, but also in pinpointing for the government those transactions which have raised their suspicions.[26] Yet even where there is a spirit of cooperation,

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(footnote continued)

effectively with money laundering. The Commission Report discusses this topic at length (at 8-27, 51-52), but some of the problems can be briefly summarized:

(1) Suspicions of money laundering are confirmed with reliable information "only after substantial, if not indefinite, delay" (at 51). Contributing factors here, other than bank reticence to inform on its customers and the actual and perceived impediments of state or federal (RFPA) law to disclosure of financial records, see infra pp. 14-16, are: (i) the time required for processing and analyzing CTRs and CMIRs; (ii) restrictions placed on the Treasury Department in transferring CTR and CMIR data to other federal agencies; and (iii) confusion over which agency to contact concerning possible violations of the law.

(2) The principal responsibility for monitoring and investigating money laundering has rested solely with the Treasury Department and its components. Other federal agencies that could bring substantial investigative experience and resources to bear on the problem do not have the necessary jurisdiction under the BSA.

(3) The BSA, as currently administered, lacks important investigative tools: (i) the number of FBI, DEA and IRS agents available to investigate violations of the Act is insufficient; and (ii) exemption lists and lists of CTRs and CMIRs filed with the Treasury Department are rarely available to bank examiners in advance of audits in which they are expected to investigate BSA compliance.

[26] Commission Report, supra note 3, at 3, 29-30.

there exists a major impediment to translating this spirit into action.

The Right to Financial Privacy Act ("RFPA")[27] can be read to preclude financial institutions from providing federal law enforcement authorities with meaningful information about suspicious transactions.[28] In general, the RFPA prohibits government authorities from obtaining from a financial institution access to the "financial records"[29] of customers, absent customer consent or the obtaining of an administrative subpoena, summons, search warrant, judicial subpoena, or formal written request.[30] If access is obtained, notice must be given to the affected customer by the government unless a court orders otherwise,[31] and the customer may then challenge the government's right of access.[32]

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[27] 12 U.S.C. §§ 3401-3422.

[28] Commission Report, supra note 3, at 30, 59.

[29] "Financial record" is defined by the RFPA as "an original of, a copy of, or information known to have been derived from, any record held by a financial institution pertaining to a customer's relationship with the financial institution." 12 U.S.C. § 3401(2).

[30] 12 U.S.C. §§ 3405-3408. The RFPA, for the most part, does not apply to grand jury subpoenas. 12 U.S.C. § 3413(i). Thus, for example, no government customer notification requirement attaches to the use of grand jury subpoenas (although banks themselves frequently notify customers of grand jury subpoenas, see infra p. 17 & n.39).

[31] 12 U.S.C. §§ 3405-3409.

[32] 12 U.S.C. § 3410.

Voluntary disclosures of such records by the financial institutions themselves are controlled by § 1103 of the RFPA, which -- while generally prohibiting financial institution disclosure of customer information to government authorities, except in accordance with the provisions of the Act -- states that "[n]othing in [the RFPA] shall preclude" a financial institution from notifying a government authority that it has "information which may be relevant to a possible violation of any statute or regulation."[33]

Notwithstanding the leeway that this provision on its face appears to provide financial institutions to disclose important information voluntarily, the prospect of customers seeking damages and injunctive relief against financial institutions that disclose information in violation of the Act[34] appears to have encouraged a conservative reading of § 1103(c) among financial institutions. This tendency has been heightened by the failure of the RFPA to define anywhere the nature of the "information" that may be voluntarily disclosed pursuant to § 1103(c). This conservative tendency has been heightened still further by the fact that there do not appear to be any reported federal decisions construing the amount of voluntary disclosure permitted and that there is at least one state court decision -- relying on common law notions of privacy and implied warranties of confidentiality -- that has held a bank liable for wrongful disclosure of customer financial records to local police.[35]

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[33] 12 U.S.C. § 3403(c). Cf. 12 U.S.C § 3413(a) ("Nothing in this chapter prohibits the disclosure of any financial records or information which is not identified with or identifiable as being derived from the financial records of a particular customer.").

[34] See §§ 1117-1118 of the RFPA (12 U.S.C. §§ 3417-3418).

As a consequence, most voluntary disclosures will not include a customer's name and will consist at best of not much more than an assertion that there is possibly relevant information waiting to be had. This type of unsupported assertion, in turn, is hardly sufficient or specific enough to justify a federal agency opening a formal investigation and thereafter complying with the elaborate procedures required by the RFPA.[36]

An additional, if lesser, difficulty under the RFPA is that, with two minor exceptions, § 1113(i) of the

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[35] See Suburban Trust Co. v. Waller, 44 Md. App. 335, 408 A.2d 758, 764 (1979), where the court held that "absent compulsion by law, a bank may not make any disclosures concerning a depositor's account without the express or implied consent of the depositor." Whether the court's holding would be extended to a situation where the disclosure extends merely to the customer's name, accompanied by an assertion that an investigation might turn up interesting information, is unclear.

[36] Commission Report, supra note 3, at 30, 59.

RFPA exempts grand jury subpoenas from the coverage of the RFPA's provisions.[37] This exemption has the perverse effect of preventing a federal agency from using § 1109 of the RFPA[38] to obtain an order prohibiting a bank or financial institution from voluntarily notifying its customers that grand jury subpoenas have been served. Indeed, many states have laws requiring financial institutions to notify customers whose records are the subject of grand jury subpoenas. The end result is that the investigative usefulness of the grand jury subpoena is undercut because the federal agency may be powerless to prevent the financial institution from giving notice to its affected customer about its receipt of a grand jury subpoena.[39]

III.

Legislative Approaches to Combatting Money Laundering

A. Corrective Legislation (BSA)

The Commission Report, having detailed the weaknesses in the current tools available for preventing money laundering, proceeds to propose a number of ways of dealing with the identified problems. For purposes of this Report, the critical proposals are the Commission's legislative suggestions. However, the Commission has also suggested adoption by financial institutions of voluntary guidelines and changes in administrative practices with respect to the BSA -- which in general we are inclined to support.[40]

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[37] 12 U.S.C. § 3413(i).

[38] 12 U.S.C. § 3409.

[39] Commission Report, supra note 3, at 30-31.

The legislative proposals are both remedial and interstitial, aimed at strengthening the BSA and filling gaps the BSA does not cover. Specifically with respect to shoring up the BSA as a prosecutorial weapon, the Commission Report recommends[41], *inter alia*, that:

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[40] Some of the proposed voluntary guidelines, *id*. at 53-56, are to:

(1) designate one mid-level manager to be ultimately responsible for completion and review of all CTRs;

(2) train bank officers and employees to recognize features common to money laundering schemes;

(3) generate internal audits devoted solely to ensuring BSA compliance; and

(4) tighten procedures for granting customer exemptions from the BSA's reporting requirements.

Some of the proposed new administrative practices, *id*. at 56-58, are to:

(1) prepare an analysis of CTRs, CMIRs and FBARs via the Treasury Department to target the foreign countries most heavily used for money laundering from the United States;

(2) consolidate the processing of CTR data into a single location;

(3) increase Treasury Department personnel, assign additional agents to the IRS office that handles BSA compliance, and designate that office as

(footnote continued)

(1) the BSA be amended to provide for rewards for information leading to the imposition of penalties under the Act;

(2) the BSA's restrictions on the interagency transfer of information and data generated pursuant thereto be relaxed;

(footnote continued)

the initial contact point for financial institutions concerning suspicious transactions and BSA problems;

(4) increase the personnel available to the Attorney General (through the FBI and DEA) for investigations of money laundering-related violations within their respective jurisdictions;

(5) make information processing easier by standardizing a procedure whereby a financial institution can make a special notation on any CTR or CMIR that it believes involves a questionable transaction, and then pass it on to the appropriate government authority;

(6) arrange for the generation of exemption lists, and lists of CTRs and CMIRs, that have been received by the Treasury Department from particular financial institutions, and for the transmission of those lists to bank examiners or other auditors in advance of their audits of those institutions; and

(7) tighten Treasury regulations under the BSA to create stricter procedures in instances where an institution exercises its authority to exempt a customer from the reporting requirements of the BSA.

[41] *Id*. at 59-61.

(3) the BSA's civil and criminal penalties be increased; and

(4) the penalties under 18 U.S.C. §§ 215 and 216 for bribery of bank officials be increased.[42]

We do not intend to discuss these recommendations in detail herein, as they are not included in the pending Congressional proposals. However, the recommendations do appear to remedy a number of the identified weaknesses in the current tools and practices available under the BSA to combat money laundering.

B. Additional Legislation

The Commission Report recognizes, however, that additional legislation, aimed at attacking the money laundering problem directly, is also essential. Accordingly, the linchpin of the Commission's proposed legislative program is its call for a money laundering statute to "strike directly at the heart of the problem by making the use of financial institutions by money launderers a criminal offense."[43]

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[42] Subsequent to the issuance of the Commission Report in October 1984, Congress acted to amend these provisions by merging §§ 215 and 216 into a single, expanded and revised § 215 that, *inter alia*, now covers the bribe offeror as well as the bribe recipient, *and* provides for heavier penalties all around. *See* Pub. L. No. 98-473, Title II, § 1107, 98 Stat. 2145 (1984). For an explanation and comparison of new § 215 with its predecessors, *see* S. Rep. No. 225, 98th Cong., 2d Sess. 374-76, *reprinted in* 1984 U.S. Code Cong. & Ad. News 3182, 3515-17.

In conjunction with this call for a money laundering statute, the Commission Report also recommends the passage of amendments to the RFPA designed to enable, but not to compel, financial institutions to volunteer sufficient information to put authorities on the track of suspicious transactions without fear of liability to customers.[44]

IV.

Comparison of Proposals for Additional Legislation

The Commission's call for both a money laundering statute and amendments to the RFPA has been met with a flurry of congressional proposals of which the three bills referred to earlier appear to be the primary ones under consideration. These three bills seem to define the range of responses to the problems identified by the Commission: (i) H.R. 2786, the Administration's bill, is the most encompassing, proposing a money laundering statute (18 U.S.C. § 1956), amend-

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[43] Commission Report, _supra_ note 3, at 62.

[44] _Id_. at 59. An appendix to the Commission Report includes draft legislation containing both a money laundering statute and amendments to the RFPA. H.R. 1367, Representative McCollum's bill, is almost a verbatim adoption of this draft legislation.

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ments to the RFPA, and an additional proposal, not discussed in the Commission Report, rendering the receipt of criminal proceeds a new federal criminal offense (18 U.S.C. § 2322); (ii) H.R. 1367, introduced by Representative McCollum, tracks the Commission's suggested legislation closely, and includes both a money laundering statute and amendments to the RFPA; and (iii) H.R. 1474, introduced by Representative Hughes, is the most concise, but only contains a money laundering statute, without RFPA amendments.

Comparison of these bills focuses attention on a number of substantive issues and policy questions. What follows is a summary of the key provisions of each bill and the issues that they present. This is intended as background to the subsequent and more detailed analysis in Section V of the questions posed by the three bills.

A. Money Laundering Statute

The three bills define a new money laundering substantive offense as follows:

(1) H.R. 2786 -- The Administration's proposal:

> (a) Whoever conducts, causes to be conducted, or attempts to conduct a transaction involving the movement of funds by wire or other electronic means or involving one or more monetary instruments, which in any way or degree affects interstate or foreign commerce, or conducts, causes to be conducted, or attempts to conduct such a transaction, through or by a financial institution

which is engaged in, or the activities of which affect, interstate or foreign commerce in any way or degree --

> (1) with the intent to promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity; or
>
> (2) knowing or with reckless disregard of the fact that such monetary instruments or funds represent the proceeds of, or are derived directly or indirectly from the proceeds of, any unlawful activity . . . [commits a felony].45

(2) H.R. 1367 -- The Commission's proposal:

(a) Whoever conducts or causes to be conducted a transaction or series of transactions involving one or more monetary instruments in, through, or by a financial institution which is engaged in, or the activities of [which] affect, interstate commerce, or attempts to do so --

> (1) with intent to promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity; or
>
> (2) with knowledge or reason to know that such monetary instruments represent income derived, directly or indirectly, from

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45. Money laundering offenses under H.R. 2786 are criminally punishable by "a fine of not more than $250,000 or twice the value of the [laundered] funds, whichever is greater, or imprisonment for not more than twenty years, or both." Additionally, H.R. 2786 provides for a civil penalty of not more than the greater of the value of the laundered funds or $10,000.

> any unlawful activity, or the proceeds of such income . . . [commits a felony].46

(3) H.R. 1474 -- Representative Hughes' proposal:

> (a) OFFENSE. -- Whoever knowingly engages or attempts to engage in a financial transaction in criminally derived property shall be punished as provided in subsection (b).47

These efforts to define the crime of money laundering raise at least four important issues: first, the level of scienter (mens rea) required to be found guilty of this offense; second, the breadth of the financial transactions which may constitute money laundering; third, the breadth of unlawful activity that may generate the laundered funds; and

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46. Criminal punishment for first-time offenses under H.R. 1367 consists of a fine of "not more than $250,000 or twice the value of the [laundered funds], whichever is greater, or imprison[ment] not more than five years, or both." Subsequent offenses are subject to a fine of up to the greater of $1,000,000 or five times the value of the laundered funds, and/or up to ten years imprisonment. There are no separate civil penalty provisions.

47. The term "criminally derived property" is subsequently defined as: "any property constituting, or derived from, proceeds obtained, directly or indirectly, from a criminal offense that is listed in [18 U.S.C. § 1961(1)]," which, in turn, defines "racketeering activity" for RICO purposes.

Violations of H.R. 1474's money laundering statute are criminally punishable by in the case of an individual, a fine of not more than $1,000,000 and/or imprisonment up to five years, or in the case of an offense committed other than by an individual, a fine of not more than $5,000,000. In either case, an alternate fine is imposable of not more than twice the value of the laundered funds.

fourth, the extent to which the offense should have extraterritorial application.[48]

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[48] Compare Britain's proposed Drug Trafficking Offenses Bill, which was introduced in December 1985 and in pertinent part provides:

> *Offense of assisting drug traffickers*
>
> 15.--(1) If a person enters into or is otherwise concerned in an arrangement whereby --
>
> (a) the retention or control by or on behalf of another (call him "A") of the proceeds of drug trafficking by A is facilitated (whether by concealment, removal from the jurisdiction, transfer to nominees or otherwise), or
>
> (b) the proceeds of drug trafficking by A --
>
> (i) are used to secure that funds are placed at A's disposal, or
>
> (ii) are used for A's benefit to acquire property by way of investment,
>
> *knowing or suspecting or having reasonable grounds to suspect that A is a person who carries on or has carried on drug trafficking*, he is guilty of an offense (emphasis added).

Although most of the provisions of the Bill deal with empowering courts to make substantial forfeiture orders to deprive an offender of the total value of the proceeds of his drug trafficking, this particular section creates a new offense of assisting another to retain the benefits of drug trafficking. It plainly encompasses money laundering transactions, but it does not, in our view, do so in a fashion we in this country should wish to emulate. As drafted, this section of the Bill appears to require the government to prove that the offender has the relevant *mens rea* only with respect to the drug trafficker's *status* as someone who "carries on or *has carried on* drug trafficking," and *not* with respect to the drug-related nature of the specific *transaction* in question (although a separate clause within this section does allow lack of *mens rea* with respect to the transaction to be proved as an affirmative defense). Thus, for example, it would appear to be illegal under this Bill to sell a home to a person one *suspects* has *previously* engaged in drug trafficking. This approach is not only questionable as a matter of policy, but also would raise numerous constitutional issues if applied in this country.

1. Mens Rea -- The issue here is what level of scienter will create a statute of adequately-inclusive scope without simultaneously running an unacceptable risk of including innocent conduct.

H.R. 1474 creates a single-tiered standard of culpability, attaching liability to anyone who "knowingly" engages or attempts to engage in a money laundering transaction. This standard is purely subjective, *i.e.*, what did the person *actually* know?

H.R. 2786 and H.R. 1367 create two-tiered standards of culpability. The first tier is also purely subjective -- a person is liable only if he acts with an intent to further the underlying unlawful activity. In the second tier, these two bills vary.

H.R. 1367 proscribes transactions committed with "knowledge or *reason to know* that such monetary instruments represent income derived, directly or indirectly, from any unlawful activity, or the proceeds of such income . . ." (emphasis added). "Reason to know" is not defined anywhere within the bill, but plainly suggests an objective standard, *i.e.*, what *should* the person have known?

H.R. 2786 states that a person commits a proscribed transaction when he acts "knowing *or with reckless disregard* of the fact that such monetary instruments or funds represent the proceeds of, or are derived directly or indirectly from the proceeds of, any unlawful activity . . ." (emphasis added). "Reckless disregard" is defined in H.R. 2786 to mean that "the person is aware of a substantial risk that the monetary instruments or funds involved in the transaction represent the proceeds of, or are derived directly or indirectly from the proceeds of, any unlawful activity, but disregards the risk." "Substantial risk" is then defined in gross negligence terms as a risk "of such a nature and degree that to disregard it constitutes a gross deviation from the standard of care that a reasonable person would exercise in such a situation."

The section by section analysis of H.R. 2786 supplied by the Administration explains that "the required state of mind involves a consciousness of the substantial possibility that the funds are tainted and is far removed from the standard of mere negligence or [as contained in Congressman McCollum's bill (H.R. 1367)] 'reason to know.'" More accurately, however, defining "reckless disregard" in the terms of being "aware of a substantial risk" incorporates both subjective and objective measurements: (1) did the actor actually become aware of, or consciously advert to, the risk (subjective); and (2) would a reasonable person have disregarded the risk (objective)?

2. Financial Transaction -- The issue here is whether the scope of a money laundering statute should be broadly defined to cover all financial transactions in which unlawfully generated funds are employed, or be limited to those financial transactions in which a bank or other "financial institution" is employed. H.R. 2786 defines "transaction" broadly;[49] as a result, cash transactions with anyone -- grocers, lawyers, or sellers of homes -- are seemingly subject to prosecution. H.R. 1474 and H.R. 1367 are narrower and require that the money laundering transaction involve a "financial institution."[50]

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[49] H.R. 2786 provides:

> the term "transaction" includes but is not limited to a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes but is not limited to a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected.

[50] H.R. 1367 provides:

> the term "transaction" includes, but is not limited to, a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected . . . (emphasis added).

(footnote continued)

3. Unlawful Activity -- The issue here is the range of underlying criminal offenses ("unlawful activity") that can give rise to laundered funds. Too broad a coverage may run the risk of federalizing crimes traditionally prosecuted at the state level and dispersing scarce and valuable federal resources; too narrow a coverage may create a statute of limited reach that insufficiently attacks the money laundering problem.

Again, the Administration's bill, H.R. 2786, provides the broadest coverage by defining "unlawful activity" as any act occurring in whole or in part in the United States which is a felony under federal or state law. As a result, in conjunction with its definition of "transaction," H.R. 2786's definition of "unlawful activity" has the potential to transform into a federal money laundering offense any financial transaction utilizing or involving the proceeds of a felony.

By contrast, H.R. 1474 and H.R. 1367 limit the definition of "unlawful activity" (H.R. 1474 refers instead

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(footnote continued)

H.R. 1474 provides:

> the term "financial transaction" means the deposit, withdrawal, transfer, or exchange, of funds or a monetary instrument (as defined for the purposes of subchapter II of chapter 53 of title 31) by, through, or to a financial institution (as defined in section 5312(a)(2) of title 31) . . . (emphasis added).

to "criminally derived property") for the most part to federal offenses. H.R. 1474 includes only "racketeering activity" as defined under RICO (which does include a limited number of serious state law offenses).[51] H.R. 1367 similarly focuses on selected RICO "racketeering activity" offenses, but specifically excludes state law RICO offenses and securities law violations.

4. Extraterritorial Application -- The issue here is the extent to which a new money laundering offense should have extraterritorial application. Each of the legislative proposals specifically provides for extraterritoriality. H.R. 1367 does so in a single sentence to the effect that "there is extraterritorial jurisdiction over the conduct prohibited by this section." H.R. 1474's language is virtually identical.

The Administration's proposal, H.R. 2786, differs from these two bills in that it limits extraterritorial jurisdiction in four ways. First, it narrows what constitutes the underlying "unlawful activity" domestically under H.R. 2786, *i.e.*, any state or federal felony, to violations of Title 18, a criminal violation of the Internal Revenue Code, a drug trafficking violation, or a violation of one of several listed espionage-type crimes. Second, the defendant must act with a specific intent to launder money or have actual knowledge that the funds involved are derived from unlawful activity. (As earlier discussed, a domestic transaction under H.R. 2786 requires only a "reckless disregard" of the fact that the monies derive from unlawful activity.) Third, the conduct must be by a United States person or, with respect to a non-United States person, at least part of the conduct constituting the money laundering transaction (in contrast to the underlying crime which produced the "dirty money") must occur in the United States. Finally, the transaction or series of related transactions must involve funds of a value exceeding $10,000.

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[51] *See* 18 U.S.C. § 1961(1).

B. RFPA Amendments

Only two of the three bills, H.R. 1367 and H.R. 2786, seek to amend the RFPA. H.R. 1367 amends two subsections of the RFPA and fairly strictly tracks the legislative proposals in the Commission Report; H.R. 2786 somewhat more expansively modifies the RFPA.

The similarities and differences between the two bills help frame a complex issue: what is the extent to which financial institutions should be enabled, or even encouraged, to volunteer information to law enforcement agencies about suspicious accounts or financial transactions? At stake is a resolution of a conflict between two oft-competing societal interests: the facilitation of law enforcement and the preservation of individual privacy rights.

A number of subsidiary issues also emerge: (i) what is the extent and type of information that a voluntary disclosure should be permitted to convey; (ii) what is the standard employed by financial institutions in determining to make voluntary disclosures; (iii) to what extent should state laws that conflict with the RFPA be preempted; (iv) to what extent should the RFPA's good-faith defense be expanded to cover voluntary disclosures; and (v) under what circumstances and in what manner should the RFPA provide for notification to a customer whose financial records have been voluntarily disclosed? Additionally, certain changes proposed only by H.R. 2786 raise related issues: (vi) in what manner should the RFPA treat grand jury subpoenas; and (vii) what customer notification requirements should attach to the interagency transfer of records initially acquired in accordance with the RFPA?

1. Extent and Type of Information Permitted in Voluntary Disclosures -- The relevant language in § 1103(c) of the RFPA reads: "Nothing in this chapter shall preclude any financial institution . . . from notifying a Government

authority that such institution . . . has information which may be relevant to a possible [law] violation."[52] The RFPA does not define the extent or type of information includable in such a notification, but current interpretive practice indicates that neither identifying information concerning the customer's name or account, nor other "financial records" pertaining thereto, may be disclosed voluntarily.[53]

Although neither H.R. 2786 nor H.R. 1367 precisely defines the information that may be voluntarily disclosed by a financial institution, both bills appear to contemplate relatively open-ended and broad disclosure. H.R. 2786 is the more explicit of the two bills, and adds a new final sentence to § 1103(c), which reads: "Such [disclosed] information may include the name or names of and other identifying information concerning the individuals and accounts involved in and the nature of the suspected illegal activity." More significantly, however, H.R. 2786 also adds a new paragraph (l) to § 1113 of the RFPA, dealing with exemptions to the Act:

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[52] 12 U.S.C. § 3403(c).

[53] See supra pp. 14-16 & nn.29-33.

> Nothing in this title shall apply when a financial institution or supervisory agency, or any officer, employee, or agent of a financial institution or a supervisory agency, provides to an agency of the United States financial records which such financial institution or supervisory agency has reason to believe may be relevant [to a possible law violation] (emphasis added).

The effect of these two changes made by H.R. 2786 plainly is to permit voluntary disclosure of financial records beyond identifying customer and account information.

H.R. 1367's effect is less clear, but it appears to cause approximately the same result. First, H.R. 1367 alters § 1103(c) to provide that voluntary disclosure can be made when the financial institution has information "which it believes may be relevant to a possible [law] violation" (emphasis added). It then adds language to the end of § 1103(c) that explicitly contemplates voluntary disclosure: "and thereafter disclosing such information to that Government authority, regardless of whether a subpoena, summons, search warrant, or formal written request has been issued . . . " (emphasis added). The net effect is to allow voluntary disclosure of "such information" that the financial institution "believes may be relevant to a possible [law] violation." This language would appear to go well beyond disclosure of the customer's name, address and account number, to include substantial other financial records and information derived therefrom.

The extent of voluntary disclosure permitted under these two bills is further clarified by examining those portions of the bills which would extend the "good-faith" defense currently available in § 1117(c) of the RFPA. That section protects financial institutions against civil liability to the affected customer when the financial institution has disclosed financial records in good-faith reliance upon a government certificate of compliance with the RFPA.[54] Each bill would extend the good-faith defense to any financial institution "making a disclosure of the financial records of a customer, or information contained in such records,[55] . . . in good-faith belief that such records or information may be relevant to a possible [law] violation" (emphasis added). Whether or not the good-faith defense should be extended to voluntary disclosures is a separate issue, see infra pp. 73-74, but as drafted, each bill's good-faith defense section plainly permits voluntary disclosures that could include extensive revelation of the financial records of a specific customer.

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[54] 12 U.S.C § 3417(c).

[55] As currently defined in 12 U.S.C. § 3401(2), the term "financial record" already means either the record itself or information derived therefrom. See supra note 29. Both bills, however, seem to treat the actual record and information derived therefrom as separate items (see text above). This suggests that, for clarity's sake, either a redefinition of "financial records," or a usage of the term in the bills to conform better to the current definition, would be appropriate. See infra note 92.

2. Standard Employed by Financial Institutions in Determining to Make Voluntary Disclosures -- The RFPA amendments contained in H.R. 2786 and H.R. 1367 and discussed immediately above also raise the question of the appropriate standard by which financial institutions should measure the propriety of making voluntary disclosures.

Section 1103(c) now simply provides that "[n]othing in this chapter shall preclude" a financial institution from notifying a Government authority that it has information "which may be relevant to a possible [law] violation."[56] H.R. 1367 changes this wording to read: "which it believes may be relevant . . . " (emphasis added), thereby clearly indicating that the standard for disclosure rests in the financial institution's discretion and is subjective. H.R. 2786 leaves this aspect of § 1103(c) untouched, but in adding a new paragraph (1) to § 1113 of the RFPA exempts from the coverage of the Act instances in which a financial institution provides to a federal agency financial records which it "has reason to believe may be relevant to a possible law violation" (emphasis added). This language suggests a purely objective standard.

3. Preemption of Conflicting State Laws -- The RFPA currently has no provision explaining how it interacts

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[56] 12 U.S.C. § 3403(c) (emphasis added).

with state laws that independently deal with financial privacy rights. As a consequence, state court decisions recognizing a customer's state law right of privacy in his or her institutionally-held financial records have served to restrain financial institutions from making voluntary disclosures.[57]

H.R. 1367 addresses this issue by adding an additional paragraph to § 1103(c) explicitly preempting the provisions of any state law, constitution, or judicial decision "that is not identical to the provisions of this subsection and regulations thereunder, and that is more restrictive of disclosure to a Government authority concerning a possible violation of any statute or regulation than the provisions of this subsection and regulations promulgated thereunder."

H.R. 2786's preemption of state authority language is identical to that of H.R. 1367, except that instead of being appended to § 1103(c) and covering only the provisions on voluntary disclosure contained in that subsection, it is set out as a separate section, preempting state law insofar as it would apply to any provision of the RFPA.

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[57] See, e.g., Suburban Trust Co. v. Waller, 44 Md. App. 335, 408 A.2d 758 (1979) and discussion supra p. 16 & n.35. Although the Supremacy Clause of the United States Constitution requires provisions of state law to give way to provisions of the RFPA with which the state law is in direct conflict, in practice courts have given the RFPA preemptive effect in relatively few instances. See, e.g., In re Grand Jury Subpoena (Conn. Savings Bank), 481 F. Supp. 833 (D. Conn. 1979) (preempting state law imposing customer notification requirements on the issuer of a grand jury subpoena).

4. Extension of the Good-Faith Defense to Voluntary Disclosures -- Section 1117(c) of the RFPA provides that "[a]ny financial institution or agent or employee thereof making a disclosure of financial records pursuant to this chapter in good-faith reliance upon a certificate [of compliance with the RFPA] by any Government authority shall not be liable to the customer for such disclosure."[58]

Both H.R. 1367 and H.R. 2786 extend this good-faith defense to "a disclosure of the financial records of a customer, or information contained in such records, . . . in good-faith belief that such records or information may be relevant to a possible [law] violation . . . ." H.R. 2786's drafting appears somewhat more meticulous here in that it also specifies that for the good-faith defense to apply to voluntary disclosures, such disclosures must be made in accordance with the appropriate sections of the RFPA.

Significantly, both bills extend the good-faith defense to "any failure to *notify* the customer of such [compelled or voluntary] disclosure" (emphasis added). *See infra* p. 40. Also of significance is the bills' choice of language for the good-faith defense. Each implies that voluntary disclosures may encompass the financial records of customers beyond identifying name or account information. See supra p. 35.

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[58] 12 U.S.C. § 3417(c).

5. Customer Notification Requirements in Voluntary Disclosure Situations -- Currently, when the government seeks disclosure of financial records pursuant to the RFPA by obtaining and serving on the financial institution the appropriate administrative summons, subpoena, search warrant, judicial subpoena, or formal written request,[59] the government is required, unless a court on government application orders otherwise, to provide simultaneous notice to the affected customer that his or her records have been requested for investigation.[60] The underlying idea of such notice is to provide the affected

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[59] See 12 U.S.C. §§ 3405-3408.

[60] See 12 U.S.C. §§ 3405-3409. The RFPA does not specify whether or not a financial institution, as well, can notify the affected customer in such instances. Case law, however, indicates that the intent of the RFPA was to leave this decision entirely to the discretion of the bank or financial institution. See In re Castiglione, 587 F. Supp. 1210 (E.D. Cal. 1984); In re Grand Jury Subpoena Duces Tecum, Dated Dec. 9, 1983, 575 F. Supp. 1219 (E.D. Pa. 1983). This discretion has been bordered on both ends, however, by the inquiring agency's power to seek a court order prohibiting such notification, see 12 U.S.C. § 3409, and by state authority compelling such notification in the case of a grand jury subpoena, see supra p. 17.

customer with the opportunity to challenge the government's right of access to his or her records.[61]

If a disclosure is made voluntarily by the financial institution, however, no provision of the RFPA addresses what, if any, customer notice must be given, or by whom. This result is understandable, though, since voluntary disclosure under the RFPA as presently constituted is so limited that it apparently does not even include customer identification information, let alone specific financial records.

Since both H.R. 2786 and H.R. 1367 dramatically liberalize the amount of information that a voluntary disclosure may contain, see supra pp. 33-35, the issue of customer notification in the voluntary disclosure context becomes more significant. Neither bill, however, chooses to amend the RFPA so as to extend to voluntary disclosure situations the requirement of customer notification by the government. Nor does either bill impose such notification requirements on the financial institution making the voluntary disclosure. Instead, all either bill does is to extend the RFPA's current good-faith defense in § 1117(c) to "any failure to notify the customer of such [compelled or voluntary] disclosure," see supra p. 38, thereby clarifying that the financial institution has no duty of notification in any disclosure situation, see supra note 60.

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[61] See 12 U.S.C. § 3410.

6. *RFPA Applicability to Grand Jury Subpoenas* -- Section 1113(i) of the RFPA, with two exceptions, exempts grand jury subpoenas from the coverage of its provisions.[62] As a consequence, as discussed earlier, *see supra* p. 17, a federal agency which requests financial records by means of a grand jury subpoena is without power under § 1109 of the RFPA to obtain an order prohibiting disclosure by the financial institution to its affected customer of such institution's receipt of a grand jury subpoena. Absent the explicit existence of this power in the provisions of the RFPA, some courts have concluded that Rule 6(e) of the Federal Rules of Criminal Procedure prevents the government from obtaining an order requiring the financial institution to maintain secrecy concerning the grand jury subpoena.[63]

H.R. 2786 addresses this issue by amending Rule 17(c) of the Federal Rules of Criminal Procedure to permit the government to apply for a court order commanding a subpoena recipient to maintain silence for a specified period of time about the existence of the subpoena. In language paralleling the

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[62] 12 U.S.C. § 3413(i).

[63] *See In re Grand Jury Subpoena (East Nat'l Bank of Denver)*, 517 F. Supp. 1061 (D. Col. 1981); *In re Grand Jury Subpoena Duces Tecum, Dated Dec. 9, 1983*, 575 F. Supp. 1219 (E.D. Pa. 1983). *But see In re Swearingen Aviation Corp.*, 486 F. Supp. 9 (D. Md. 1979) (granting order restricting disclosure by financial institution to customer of its receipt of a grand jury subpoena).

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standards for entering such an order under § 1109 of the RFPA, the order is only to issue if the court determines that there is reason to believe that the material designated in the subpoena is relevant to a legitimate law enforcement proceeding and that there is reason to believe that notification of the existence of the subpoena will result in endangering the safety of any individual, flight from prosecution, destruction of evidence, intimidation of potential witnesses, or in "otherwise seriously jeopardizing an investigation or unduly delaying a trial."

H.R. 2786 would also amend § 1120 of the RFPA, one of the Act's two excepted sections that continue to apply to grand jury subpoenas, notwithstanding § 1113(i).[64] Section 1120 generally restricts the allowable uses of financial records that are obtained via grand jury subpoena. H.R. 2786 would amend § 1120 by deleting subsection (1) thereof, which requires that records obtained by means of grand jury subpoena "shall be returned and actually presented to the grand jury."[65]

H.R. 1367 would amend neither Rule 17(c) of the Federal Rules of Criminal Procedure nor § 1120 of the RFPA.

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[64] The other is § 1115, dealing with cost reimbursements to financial institutions assembling records in response to a government request or subpoena.

[65] 12 U.S.C. § 3420(1).

7. Customer Notification Requirements for Interagency Transfer of RFPA-Obtained Records -- The transfer to other agencies or departments of financial records originally obtained pursuant to the RFPA is controlled by § 1112 of the RFPA, which requires, *inter alia*, certification in writing that there is reason to believe that the records are relevant to a legitimate law enforcement inquiry within the jurisdiction of the receiving agency or department, and mailing of a copy of the certification and of a designated notice to the affected customer within 14 days of the transfer (but allowing for a court-ordered delay in such mailing if appropriate under the standards of § 1109).[66]

H.R. 2786, but not H.R. 1367, would amend § 1112 to eliminate these two requirements. A transferring agency would still need reason to believe that the records may be relevant to the law enforcement functions of the receiving agency, but no written certification or customer notification requirement would thereafter apply.

C. The New Receiving Crime

Only H.R. 2786 contains a provision (§ 8), defining a new criminal offense called "Receiving The Proceeds of a Crime." This provision, which would create a new § 2322 of

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[66] 12 U.S.C. § 3412.

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Title 18, actually defines two offenses, the first of which applies to "[w]hoever receives . . . any money or other property which has been obtained in connection with a violation of any law of the United States" that is punishable as a felony, "knowing or believing the same to be money or property which has been obtained in violation of law" (emphasis added).

The second offense defined by the new § 2322 applies to "[w]hoever . . . brings or transfers into the United States any money or other property which has been obtained in connection with a violation of any law of a foreign country" concerning drug trafficking and punishable by more than one year's imprisonment, "knowing or believing the same to be money or property which has been obtained in violation of law" (emphasis added).

The key issue here, given that the Commission Report does not suggest the need for this type of legislative response to the money laundering problem, is the overall appropriateness of adding a § 2322. More specifically, the actus reus and mens rea components of the two offenses must be examined to see whether they define as crimes actions that should, from a policy viewpoint, create substantive criminal liability.

V.

Analysis of the Issues Raised by Proposals for Additional Legislation

A. Money Laundering Statute

The need for a money laundering statute seems plain. As the Commission Report makes evident, nothing short of new legislation will "strike directly at the activities in which money launderers engage."[67] As noted earlier, see supra pp. 9-10, money launderers who comply with the recordkeeping and reporting requirements of the BSA by completing CTRs and other required forms "can operate with virtual impunity, unless and until it can be proved that the launderer has violated another Federal statute."[68] Similarly, money laundering transactions under $10,000, or otherwise outside the scope of coverage of the BSA (e.g., wire transfers do not require CMIRs), avoid penalties. Moreover, bank officials and employees who know that money laundering is occurring, but nonetheless continue to file the requisite BSA forms, also may escape liability.

Accordingly, a statute -- narrowly designed to address these issues by criminalizing the knowing participation in or facilitation of money laundering schemes -- would appear to be an effective and necessary complement to the existing statutes (i.e., the BSA) available to combat money laundering. By increasing both the amount and likelihood of incurring penalties for money laundering activities, such legislation should act as a more definite deterrent. It would also squarely attack the money laundering problem and serve the dual purposes of striking at organized crime and protecting the integrity of financial institutions.

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[67] Commission Report, supra note 3, at 61. The need for specific legislation aimed directly at money laundering has been recognized as well in Great Britain, where a Drug Trafficking Offences Bill that deals, inter alia, with money laundering, was published in December 1985. See supra note 48.

[68] Commission Report, supra note 3, at 61.

1. Mens Rea.

A very troublesome aspect of the money laundering statutes contained in the legislative proposals is the level of culpability giving rise to criminal liability. The scienter requirement must create a statute that is broad enough to reach those persons actively involved in money laundering, but narrow enough to avoid covering innocent parties.

The "reason to know" standard[69] of H.R. 1367 and to a lesser degree the "reckless disregard" standard of H.R. 2786 are objectionable because they may in practical application, particularly when presented to a jury, give rise to convictions for what is merely negligent conduct. The difficulty is that each standard, either definitionally or through connotations associated with common usage, creates a purely objective basis upon which to convict a defendant, *i.e.*, these standards ask what *should* the defendant have known or done. These standards will thus also create uncertainty among financial institutions and the public at large over what constitutes the offense of money laundering.

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[69] Such a standard has few precedents in existing federal criminal statutes. But see, Foreign Corrupt Practices Act, 15 U.S.C. § 78dd-2(a)(3).

These objective standards go well beyond the money laundering problem as defined by the Commission Report and testimony before Congress. Typical money launderers are persons who actually know they are dealing with "dirty money" or have a strong suspicion with regard thereto but deliberately close their eyes in order to avoid confirming that suspicion. Such subjective knowledge is what differentiates the true money launderer from the multitudes of persons engaged in everyday financial transactions who may inadvertently aid in a transfer of illegally acquired funds. The wire transfer of funds or the issuance of a money order, for example, involves the same action by a bank employee whether or not he or she is a money launderer. What makes the bank employee a money launderer is what the employee knows about the funds that he or she is handling.

Accordingly, the scienter requirement should be one that is unmistakably subjective, *i.e.*, the standard should ask

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what did the defendant actually know. The mens rea definition of "knowingly" contained in H.R. 1474, we believe, accomplishes this goal.

As a mens rea standard for criminal action that is defined in whole or in part by the existence of attendant circumstances, "knowingly" has always, at a minimum, included persons who have an actual awareness of the existence of these attendant circumstances. Accordingly, a money laundering offense containing a "knowingly" scienter standard will clearly pull within its scope those people who have an actual awareness that the monetary instruments involved in the financial transaction(s) are derived from, or are the proceeds of, unlawful activity.

Moreover, "knowingly" has historically also included a doctrine variously known as "conscious avoidance," "studied ignorance," or "willful blindness," which essentially states that "if a party has his suspicion aroused but then deliberately omits to make further inquiries, because he wishes to remain in ignorance, he is deemed to have knowledge."[70] In other words, knowledge exists where there is a conscious advertence to a risk or a probability that the attendant circumstances exist, followed by a deliberate decision to disregard or not pursue the suspicion, and to act regardless of the attendant circumstances.

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[70] G. Williams, Criminal Law: The General Part § 57 at 157 (2d ed. 1961).

The central difficulty in defining and applying a conscious avoidance doctrine is in determining just how probable or certain the attendant circumstances in question must be. The level of risk to be ignored for "conscious avoidance" to amount to actual awareness of attendant circumstances must be set high enough so that it is essentially "fair" to equate such avoidance with actual knowledge. At the same time, if the scienter requirement of the statute is limited to "knowingly," the level of risk to be ignored must be set low enough to enable the law to reach all actions that are meant to be proscribed. Too low a level, however, creates the possibility that the scienter requirement of "knowledge," in conjunction with a "conscious avoidance" doctrine, will overlap with, if not supplant entirely, the lesser scienter requirement of "reckless."[71]

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[71] Indeed, much of the scholarly commentary, see, e.g., American Law Institute, Model Penal Code and Commentaries, Part I, § 2.02 at 248 (1985) [hereinafter "ALI MPCC"]; Edwards, The Criminal Degrees of Knowledge, 17 Mod. L. Rev. 294, 303-06 (1954), and the case law, see, e.g., United States v. Callahan, 588 F.2d 1078, 1082 (5th Cir.), cert. denied, 444 U.S. 826 (1979); United States v. Wright, 537 F.2d 1144, 1145 (1st Cir.), cert. denied, 429 U.S. 924 (1976); United States v. Sarantos, 455 F.2d 877, 882 (2d Cir. 1972), specifically alludes to the tenuous distinction between the "concious avoidance" of knowledge of a fact and the "reckless disregard" thereof.

The most authoritative statutory effort to codify the "conscious avoidance" doctrine within a definition of "knowledge" is the Model Penal Code. Section 2.02(7) thereof reads as follows:

> Requirement of Knowledge Satisfied by Knowledge of High Probability. When knowledge of the existence of a particular fact is an element of an offense, such knowledge is established if a person is aware of a high probability of its existence, unless he actually believes that it does not exist.[72]

The "high probability" Model Penal Code definition of knowledge has received tacit Supreme Court endorsement several times.[73] And on the circuit court level, almost every circuit has explicitly adopted the tenet that "knowledge" includes the notion of "conscious avoidance."[74]

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[72] Model Penal Code § 2.02(7) (Proposed Official Draft 1962). The original draft of this language, published in Model Penal Code (Tent. Draft No. 4, 1955), required awareness only of a "substantial probability" of the fact's existence, instead of a "high probability." According to the most recent commentaries to the Code, the change made in the Official Draft reflected "the view that 'substantial' did not imply a sufficient level of probability and weakened the distinction between knowledge and recklessness as modes of culpability." ALI MPCC, supra note 71, § 2.02 at 248 n.42.

[73] See, e.g., Turner v. United States, 396 U.S. 398, 416-17 & n.19 (1970) (approving reference to the "high probability" formulation as a measure of "knowledge" under former 21 U.S.C. § 174 (now § 841)); Leary v. United States, 395 U.S. 6, 46 n.93 (1969) (Model Penal Code definition used as a "general guide" to determine the scope of the word "knowing" in former 21 U.S.C. § 176(a)); see also Barnes v. United States, 412 U.S. 837, 845 & n.10 (1973) (18 U.S.C. § 1708 construed). Turner and Barnes also more generally endorse the "conscious avoidance" doctrine outside of the Model Penal Code context, noting that awareness of the attendant circumstances inevitably existed in each case "unless [defendants] practice[d] a studied ignorance to which they are not entitled." Turner, 396 U.S. at 417; Barnes, 412 U.S. at 845 n.10 (quoting Turner).

Given this construction of the "knowingly" standard, its use in a money laundering statute will allow prosecution only of those who either know or are consciously aware of a high probability that they are participating in a money laundering transaction, and not of those who merely carelessly or unwittingly participate in such transactions.

Even under the "knowingly" standard, however, provisions should be made in the money laundering statute for

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[74] See, e.g., United States v. Wright, 537 F.2d 1144, 1145 (1st Cir.) ("['knowingly'] scienter requirement can be met when there is a reckless disregard as to the truth of the statements to which one subscribes and when there is a conscious purpose to avoid the truth."), cert. denied, 429 U.S. 924 (1976); United States v. Cincotta, 689 F.2d 238, 243 n.2 (1st Cir.) ("[e]vidence of conscious avoidance is merely circumstantial evidence of knowledge"), cert. denied, 459 U.S. 991 (1982); United States v. Squires, 440 F.2d 859, 863 (2d Cir. 1971) (court adopts Model Penal Code formulation for purposes of interpreting 18 U.S.C. § 922(a)(6)); United States v. Sarantos, 455 F.2d 877, 881 (2d Cir. 1972) ("[c]onstruing 'knowingly' in a criminal statute to include willful blindness to the existence of a fact is no radical concept in the law"); United States v. Hanlon, 548 F.2d 1096, 1101 (2d Cir. 1977) ("settled law that a finding of guilty knowledge may not be avoided by a showing that the defendant closed his eyes to what was going on about him"); United States v. Cano, 702 F.2d 370, 371 (2d Cir. 1983) ("knowledge is established if a person is aware of a high probability of its existence, unless he actually believes that it does not exist") (quoting United States v. Bright, 517 F.2d 584, 587 (2d Cir. 1975)); United States v. Caminos, 770 F.2d 361 (3d Cir. 1985) (deliberate closing of eyes to a high probability can constitute knowledge); United States v. Martin, 773 F.2d 579 (4th Cir.

(footnote continued)

persons, in particular bank employees, who complete the transaction knowing the funds are proceeds of a crime, but who immediately report the transaction to their supervisor or a law enforcement official.

An additional problem is that, as currently drafted, all three bills are ambiguous concerning the relationship of their applicable *mens rea* standards to their definition of "unlawful activity". Specifically, what in fact must a defendant know to be found guilty?

Each bill is susceptible to being read as requiring government proof that the offender had the requisite *mens rea* with regard to the fact that the unlawful activity in question, either under H.R. 1474 and H.R. 1367, constituted a

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(footnote continued)

1985) (knowledge inferrable from willful blindness); *United States* v. *Restrepo-Granda*, 575 F.2d 524, 529 (5th Cir.) (approval of equating deliberate ignorance with knowledge), *cert*. *denied*, 439 U.S. 935 (1978); *United States* v. *Seelig*, 622 F.2d 207, 213 (6th Cir.) (same), *cert*. *denied*, 449 U.S. 869 (1980); *United States* v. *Moser*, 509 F.2d 1089, 1092-93 (7th Cir. 1975) (same); *United States* v. *Massa*, 740 F.2d 629, 643 (8th Cir. 1984) (jury may "infer the element of knowledge from deliberate indifference"), *cert*. *denied*, 105 S. Ct. 2357 (1985); *United States* v. *Jewell*, 532 F.2d 697, 700 (9th Cir.) (en banc) ("to act 'knowingly' . . . is . . . also to act with an awareness of the high probability of the existence of the fact in question"), *cert*. *denied*, 426 U.S. 951 (1976); *United States* v. *McAllister*, 747 F.2d 1273, 1275 (9th Cir. 1984) (same), *cert*. *denied*, 106 S. Ct. 92 (1985); *Griego* v. *United States*, 298 F.2d 845, 849 (10th Cir. 1962) ("a conscious purpose to avoid enlightenment" is tantamount to "knowledge").

RICO-type offense, or under H.R. 2786, constituted a felony. If the mens rea level includes "reckless disregard," this extra step of proof is not much of an obstacle and probably can be inferred circumstantially. But if "knowledge" must be shown (as is argued herein), a spurious defense is created to the effect that the defendant might have known that the laundered funds derived from illegal activity, but not from illegal activity that constitutes a RICO-type offense.

Although arguably this type of hypothetical defendant might be viewed as slightly less culpable than one with more specific knowledge of the exact nature of the underlying illegal activity, we believe that the federal interest in eradicating money laundering is sufficiently strong so as not to require that this distinction be drawn. A person who is in fact laundering drug-related monies, but who thinks the funds derive from a bank robbery, should still be included within the bill's scope, since his or her contribution to the continued existence of drug money laundering is the same as someone with more accurate knowledge, and his or her level of culpability is still sufficiently high to deserve criminal conviction.[75]

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[75] Cf. United States v. Feola, 420 U.S. 671 (1975) (it is no defense to the crime of assaulting a federal officer, see 18 U.S.C. § 1114, that the defendant did not know the victim was a federal officer).

Accordingly, we are of the view that any bill should explicitly provide that *no mens rea* component attaches to the element of the money laundering offense requiring that the laundered funds be derived from a specific type of illegal activity. Knowledge that the funds derive from *any* illegal activity, if *in fact* they do derive from an illegal activity constituting an offense covered by the statute, should suffice for criminal culpability under the bill.[76]

The easiest and least obtrusive method for accomplishing this result might be simply to substitute for "any unlawful activity" wherever it appears in the bills the phrase "any illegal activity that is in fact unlawful," with "unlawful" being defined as an act or activity constituting the type of offense sought to be covered, *e.g.*, a RICO-type offense. The legislative history to the bill should then provide that the words "in fact" mean that no scienter is necessary with respect to the unlawful element. Alternatively, the bill could simply include a sentence to the effect that "where knowledge of the illegal nature of the activity generating the monetary instruments or funds exists, it shall be no defense hereunder to plead lack of knowledge that such activity constitutes an 'unlawful activity' as defined herein."

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[76] *See generally United States* v. *Freed*, 401 U.S. 601, 614-16 (1971) (Brennan, J., concurring in judgment) (discussing the crime of possession of unregistered hand grenades and concluding that knowledge is required as to the facts of possession and of the weapons being hand grenades, but not as to their unregistered status; stating also that such *mens rea* analysis is controlled solely by congressional intent).

2. Financial Transaction.

The money laundering offense defined in H.R. 2786 covers virtually any transfer of funds by means of cash, check, money order, bearer security or other negotiable instrument. It does not require the involvement of a commercial bank, savings and loan association, brokerage firm or other financial institution. As a result, cash transactions with anyone from grocery stores to law firms to sellers of homes may now be the subject of this criminal statute. Coupled with its nebulous *mens rea* standard, this definition of transaction renders H.R. 2786 dangerously broad in scope.

The history of the money laundering problem suggests that there is no need to extend the scope of the offense beyond transactions by or through "financial institutions." In the Commission Report, virtually all of the case studies presented to illustrate the extent of the money laundering problem involve financial institutions (*i.e.*, banks, brokerage firms and foreign currency dealers). The Report specifically identifies "[d]enying organized crime access to the financial institutions of this country" as a "crucial component" in the fight against money laundering and drug trafficking.[77] The only historical exceptions to the use of financial institutions to launder money are casinos and the Hells Angels' acquisition of real estate and certain "failing" businesses.[78]

In light of these facts, we believe that if the covered transactions were limited to those with financial institutions, the effectiveness of the statute would not be materially diminished. "Financial institution" is already defined in all three bills to mean an institution defined in the BSA.[79] The courts have interpreted this definition broadly to mean any enterprise, legitimate or not, or person engaged in the exchange of currency for profit.[80]

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[77] Commission Report, supra note 3, at 4. Testimony by law enforcement officials before Congress confirms the fact that financial institutions invariably are the essential link in the money laundering chain. According to the testimony of Roscoe Egger, at that time Commissioner of the Internal Revenue Service, "the objective of money laundering is to convert proceeds from questionable sources into money that can be used without question. This transformation is essential not only for spending money, but also for transporting it, since the sheer bulk of currency may cause difficulty. The use of financial institutions is essential to this process." September 12, 1985 hearing before Subcommittee on Oversight, Committee on Ways and Means.

[78] Commission Report, supra note 3, at 10-11.

[79] "[F]inancial institution" is defined by the BSA to mean:

> (A) an insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)));
> (B) a commercial bank or trust company;
> (C) a private banker;
> (D) an agency or branch of a foreign bank in the United States;

(footnote continued)

(footnote continued)

(E) an insured institution (as defined in section 401(a) of the National Housing Act (12 U.S.C. 1724(a)));
(F) a thrift institution;
(G) a broker or dealer registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.);
(H) a broker or dealer in securities or commodities;
(I) an investment banker or investment company;
(J) a currency exchange;
(K) an issuer, redeemer, or cashier of travelers' checks, checks, money orders, or similar instruments;
(L) an operator of a credit card system;
(M) an insurance company;
(N) a dealer in precious metals, stones or jewels;
(O) a pawnbroker;
(P) a loan or finance company;
(Q) a travel agency;
(R) a licensed sender of money;
(S) a telegraph company;
(T) an agency of the United States Government or of a State or local government carrying out a duty or power of a business described in this clause (2); or
(U) another business or agency carrying out a similar, related, or substitute duty or power the Secretary of the Treasury prescribes.

31 U.S.C. § 5312(a)(2).

[80] See United States v. Goldberg, 756 F.2d 949 (2d Cir.), cert. denied, 105 S. Ct. 2706 (1985). In Goldberg, officers of two banks and an employee of a gasoline wholesaler accepted $200,000 in currency in exchange for a bank check in an alleged scheme to aid a third party in opening a foreign bank account without triggering any of the reporting requirements. The Second Circuit ruled that the individuals, acting together, were a "financial institution" for purposes of the BSA. Id. at 955.

Moreover, the Secretary of the Treasury has the authority to expand the definition of "financial institution."[81] Indeed, one of the Commission Report's recommendations -- to include, pursuant to regulatory authority, "casino" in the BSA definition of "financial institution" -- has been accomplished by adoption of regulations.[82]

Given this broad meaning of "financial institution", and the government's ability to expand upon it when necessary, the money laundering statute could be limited to transactions with financial institutions without hindering the government's ability to prosecute significant money launderers. Otherwise, a grocery store clerk who takes a $50 bill from a reputed crime figure for groceries -- knowing the $50 is the fruit of a crime -- would be prosecutable as a felon.

One way to address this problem would be to fix a minimum monetary amount which must be satisfied before a transaction would be considered within the scope of a money laundering statute. This would remove the grocer and some other nonfinancial institutions from the reach of the statute. Depending upon the threshold amount chosen, however, other persons ranging from lawyers and doctors to sellers of homes

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[81] 31 U.S.C. § 5312(a)(2)(U).

[82] *Compare* Commission Report, *supra* note 3, at 58, with 50 Fed. Reg. 5065 (1985).

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would still be subject to criminal liability.[83] Persons who engage in what might be considered a one-time transaction with a felon for goods or services -- even if the person knows that he is dealing with a criminal -- have not been identified as seriously contributing to the money laundering problem and therefore should not be subject to the criminal statute, regardless of the size of the transaction. The

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[83] Including criminal defense lawyers within the scope of the statute raises serious risks of impinging upon a criminal defendant's Sixth Amendment rights. The payment of a retainer by a defendant in a criminal action to his attorney might easily render the attorney a money launderer (or at least susceptible to prosecution) under the Administration's bill. Obviously, this would limit many defendants' abilities to retain counsel.

A similar but less egregious problem has arisen under the forfeiture provisions of the Comprehensive Forfeiture Act of 1984, Pub. L. No. 98-473, Title II, §§ 301-322, 98 Stat. 2040 ("Forfeiture Act"), where federal courts have ruled that the forfeiture of attorneys' fees would effectively deter any attorney from representing a criminal defendant and thereby violate the defendant's Sixth Amendment rights. See, e.g., United States v. Badalamenti, 614 F. Supp. 194 (S.D.N.Y. 1985). Here, not only would the fee be subject to forfeiture (at least under the forfeiture provisions of § 9 of H.R. 2786, if not under the Forfeiture Act), but the defense lawyer may also be found criminally liable.

Although the potential clearly exists for attorneys actually to launder funds (through, for example, padded fees and kickbacks), this has not been identified by law enforcement officials as a typical or significant means of money laundering. Given the obvious risk to a defendant's Sixth Amendment rights, the inclusion of criminal defense attorneys under the statute by defining "transaction" broadly does not appear warranted.

(footnote continued)

money laundering statute should instead concentrate upon persons who are engaged in the business of exchanging currency for profit.[84]

An additional problem with H.R. 2786's formulation of "transaction" is that it may unnecessarily and inappropriately transform certain state crimes into federal crimes.

(footnote continued)

Existing criminal laws, in particular the aiding and abetting statute and the existing forfeiture laws, suffice as tools for law enforcement officials to prosecute attorneys who launder significant amounts of money for criminals. A limitation in the bill to transactions with financial institutions would ameliorate this problem.

For these same reasons, the new crime contained in H.R. 2786 of receiving the proceeds of a federal felony seriously threatens Sixth Amendment rights of defendants. See discussion infra pp. 79-80.

[84] Other deterrents already exist for grocers, doctors, home sellers and others who knowingly transact business with a criminal. The federal government presently has the ability to forfeit the proceeds of a crime even in the hands of a transferee who is a bona fide purchaser for value if such transferee had cause to believe such proceeds were derived from a crime. 18 U.S.C. § 1963(c); 21 U.S.C. § 853(c). These forfeiture provisions are "intended to dissuade the commercial world from dealing with racketeers and traffickers, warning that one who accepts dirty money in payment for goods or services may forfeit it." United States v. Badalamenti, 614 F. Supp. 194, 196 (S.D.N.Y. 1985). Thus, the grocer mentioned above would have to give up his $50. This seems to be a more reasonable deterrent than imposing criminal liability on the grocer. In most cases, such forfeiture provisions should eliminate the need to cover monetary transactions in the money laundering statute which are not covered by the already broadly defined term "financial institution."

Specifically, any crime involving the transfer of a monetary instrument could be considered a money laundering "transaction." A theft, a robbery, a check forgery -- giving rise to crimes traditionally prosecuted at the state level -- would become federal money laundering offenses. This effect has the potential not only to dissipate limited federal resources, but also to create friction between federal and state authorities.

The other legislative proposals, H.R. 1474 and H.R. 1367, require that the money laundering transaction involve a financial institution. We believe that this approach is clearly preferable.

3. Unlawful Activity.

"Unlawful activity" under the Administration's bill, H.R. 2786, means any act occurring in whole or in part in the United States which is a felony under federal or state law. H.R. 1474 limits the criminal offenses from which laundered money may be derived to "racketeering activity" as defined under RICO. H.R. 1367 limits the "unlawful activity" to selected RICO offenses, omitting state law RICO predicate acts and securities law violations.

A primary issue in defining "unlawful activity" is deciding whether it should include state law offenses. To the extent money laundering in and of itself is perceived as a national problem, the inclusion of state law offenses may be warranted. According to the Commission Report and testimony before Congress, however, money laundering is encouraging particular federal crimes, principally drug trafficking. Money laundering has not been presented as an impetus to particular state crimes which are not also federal crimes. We recommend at this juncture, therefore, that Congress cover only those crimes identified as benefitting significantly from money laundering.

It may be that the inclusion of state offenses as predicate crimes under the money laundering statute will be warranted in the future. It is conceivable, for example, that the federal government would have a particular interest in prosecuting someone who laundered money in New York for a Connecticut robbery ring.

We perceive several risks, however, in the inclusion of state law offenses as predicates. One, this will federalize what are traditionally state law crimes, thereby expanding the reaches of federal law and federal law enforcement investigative jurisdiction. Secondly, it will create confusion by merging certain state law offenses with the money laundering crime. For example, a theft or a check forgery -- traditionally giving rise to state crimes -- may themselves constitute financial transactions which amount to the federal crime of money laundering. Thus, as the Administration's bill is drafted, an "unlawful activity" (such as passing a forged check) could also constitute a money laundering transaction, and therefore a defendant could be charged with the federal crime of money laundering and the state law crime of forgery for precisely the same act.

Accordingly, we endorse H.R. 1367's definition of "unlawful activity," which by including "racketeering activities" as generally defined under RICO but not including state law RICO offenses or securities law violations, appears best suited to resolve these issues. It may be, however, that Congress will wish to tighten further H.R. 1367's definition of "unlawful activity" by exploring whether each of the federal offenses included has been sufficiently identified as a crime that benefits significantly from money laundering.

4. Extraterritorial Application.

International money laundering is a significant problem for United States law enforcement officials. According to the Commission, $5 to $15 billion of the $50 to $75 billion in illegal drug money earned annually in the United States moves into international financial channels.[85] Recognizing this problem, each of the bills under consideration provides for extraterritorial jurisdiction.

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[85] Commission Report, *supra* note 3, at 13.

Whereas H.R. 1367 simply provides that "there is extraterritorial jurisdiction over the conduct prohibited by this section," (and H.R. 1474's language is virtually identical), the Administration's proposal, H.R. 2786, establishes four criteria for extraterritorial jurisdiction. See supra pp. 30-31.

One of H.R. 2786's requirements -- that a United States person be involved or that at least part of the transaction occur in the United States -- plainly satisfies constitutional requirements for the exercise of extraterritorial jurisdiction by United States law enforcement officials.[86] Although courts could read such jurisdictional predicates into any legislation that purports to grant extraterritorial jurisdiction (or even legislation that does not),[87] our preference is for a statute that is explicit at the outset in its coverage. Accordingly, we endorse this aspect of H.R. 2786's extraterritorial treatment.

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[86] See generally Restatement (Second) of Foreign Relations Law § 402(1) & (2) (Tent. Draft No. 2, 1981) (specifying the bases for extraterritorial jurisdiction); see also United States v. Bowman, 260 U.S. 94, 98 (1922); United States v. Pizzarusso, 388 F.2d 8, 10 (2d Cir.), cert. denied, 392 U.S. 936 (1968). Indeed, in certain instances, it is constitutionally acceptable to extend extraterritorial reach to acts by aliens occurring wholly without the United States. See Restatement (Second) of Foreign Relations Law §402(3) & Comment (d) (Tent. Draft No. 2, 1981); United States v. Pizzarusso, 388 F.2d 8 (2d Cir.), cert. denied, 392 U.S. 936 (1968) (alien in foreign U.S. consulate knowingly making false statement under oath in visa application); Rocha v. United States, 288 F.2d 545 (9th Cir.) (same), cert. denied, 366 U.S. 948 (1961); United States v. Zehe, 601 F. Supp. 196 (D. Mass. 1985) (Espionage Act applied to non-citizen abroad).

The three remaining criteria under the Administration's bill, however, create a differentiation between domestic and international transactions that does not appear to have any sound basis. First, the explanatory commentary to H.R. 2786 offers no reason for the bill's contraction of the "unlawful activity" definition in its extraterritoriality section from the broader domestic counterpart encompassing all federal felonies. We support the notion of narrowing the definition of "unlawful activity," see supra pp. 61-63, but feel that it should be done across the board, so that the same definition applies both domestically and internationally.[88]

Second, the explanatory commentary to H.R. 2786 explains the contraction of the scienter requirement in the bill's extraterritoriality section, i.e., the deletion of the

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[87] See, e.g., United States v. Bowman, 260 U.S. 94, 98 (1922); United States v. Birch, 470 F.2d 808, 810-12 (4th Cir. 1972), cert. denied, 411 U.S. 931 (1973).

[88] One possible exception arises if the extraterritoriality provision is used to supersede the "transferring" offense defined by the second part of proposed 18 U.S.C. § 2322 ("Receiving the Proceeds of a Crime"). Then, "unlawful activity" might justifiably be expanded for extraterritorial application to include violations of foreign drug trafficking laws. See infra pp. 82-83.

"reckless disregard" component that is in the domestic definition, as resulting from the belief that the law should not impose "a duty on a United States or foreign person acting abroad to become aware of United States laws." Although we agree with the ultimate result, namely that extraterritorial application of the statute should be based on a scienter level of "knowledge" only, this is based on our belief that the domestic mens rea standard should be limited to "knowledge." The Administration's explanation not only creates a different statute for foreign operation, but suggests that for a foreign person or United States person abroad, ignorance of the law will be a defense -- a proposition we believe should be rejected.

Third, for the same reasons discussed earlier, see supra pp. 58-60, we do not support requiring a minimum $10,000 transaction for an offense to exist. The dangers of an overreaching statute are better met by limiting the type of financial transactions and unlawful activities that constitute an offense.

B. RFPA Amendments

As noted earlier, see supra pp. 14-16, the RFPA currently is being read by financial institutions as proscribing voluntary disclosure beyond a relatively meaningless statement that they have information which may be relevant to a violation of law. State common law theories of privacy and implied warranties of confidentiality, too, have resulted in prohibitions against voluntary disclosures. The need for amendments to the RFPA appears evident.

The more difficult question is what should be the scope of such amendments, and more specifically from a policy perspective, what balance should be struck between facilitating law enforcement activities on the one hand and preserving legitimate customer expectations of privacy on the other?

1. Extent and Type of Information Permitted in Voluntary Disclosures.

The Committee's view is that the findings of the Commission Report clearly justify some liberalization of the present statute. Specifically, the Committee believes that the RFPA should be amended to provide that financial institutions, and their officers, employees and agents, may disclose not only "information that may be relevant to a possible [law] violation," as under the present statute, but in addition the identity of the particular customers and accounts that are involved in the "possible violation" to which the information disclosed may be relevant.

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To this end, we endorse the approach utilized by H.R. 1367 in amending § 1103(c) of the RFPA by: (i) inserting the words "it believes" prior to the phrase "may be relevant"; and (ii) adding the phrase "and thereafter disclosing such information to that government authority, regardless of whether a subpoena, summons, search warrant or formal written request has been issued under the provisions of this chapter."[89] Both of these changes explicitly and plainly clarify that volunteerism is contemplated by the RFPA.

H.R. 2786's approach, which is to add a new paragraph (l) to § 1113 of the RFPA, see supra pp. 33-34, accomplishes the same result, but by making the entire RFPA inapplicable to voluntary disclosures -- a method which seems unnecessarily sweeping.

Adopting H.R. 1367's approach without more, however, leaves in unsatisfactory condition the extent and type of information that is voluntarily disclosable. As discussed earlier, see supra pp. 34-35, the apposite standard for voluntary disclosure would become "such information" that the financial institution "believes may be relevant to a possible [law] violation," and in conjunction with the proposed language of H.R. 1367's extended good-faith defense, this standard would appear to allow extensive voluntary disclosure of the "financial records," see supra note 29, of a customer. H.R. 2786's approach, see supra pp. 33-35, plainly would allow such disclosure.

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[89] Amended § 1103(c) would thus read:

> (c) Nothing in this chapter shall preclude any financial institution, or any officer, employee, or agent of a financial institution, from notifying a Government authority that such institution, or officer, employee, or agent has information which it believes may be relevant to a possible violation of any statute or regulation, and thereafter disclosing such information to that Government authority, regardless of whether a subpoena, summons, search warrant, or formal written request has been issued under the provisions of this chapter. [Underlining represents H.R. 1367's changes.]

The Committee believes that this amount of voluntary disclosure goes too far. Indeed, the Commission Report appears to contemplate only sufficient disclosure to place the scent of wrongdoing in the government's nose.[90] Thus, while we recognize the need to permit voluntary disclosure to include identifying information concerning the individuals and accounts involved in, and the nature and specifics of the suspected illegal activity, we believe voluntary disclosure should not otherwise extend to revealing a customer's financial records, or information derived therefrom.

Accordingly, we endorse the appending of limiting language to § 1103 (c) along the lines of: "Such information may only include the name and names of, and other identifying information concerning, the individuals and accounts involved in, and the nature and specifics of, the suspected illegal activity. It may not otherwise include financial records or information identified with or identifiable as being derived from the financial records of a particular customer."[91]

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[90] Commission Report, supra note 3, at 59.

These same concerns also necessitate that any extension to voluntary disclosure situations of § 1117(c)'s good-faith defense be drafted to coordinate precisely with the amount of voluntary disclosure an amended § 1103(c) will allow. See infra pp. 73-74.[92]

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[91] This language is roughly identical to language proposed to be added to § 1103(c) by H.R. 2786. See H.R. 2786 § 3(b). Three changes, however, significantly alter this language from that proposed in H.R. 2786. The first is the inclusion of the word "only" before "include." Whereas H.R. 2786's proposed language is intended to be explanatory of the information the voluntary disclosure may include, ours is intended to be exclusive, setting a limit to the amount of information contained in a voluntary disclosure. To drive this point home, the second change is the addition of a final sentence explicitly specifying that the disclosure may not otherwise include a customer's financial records, or information derived therefrom. The final change is the inclusion of the words "and specifics" between the words "the nature" and "of the posssible law violation." This alteration is intended to clarify that the financial institution is permitted to reveal details in its possession concerning the activities that constitute the suspected illegal activity.

[92] Additionally, the changes outlined here might benefit from greater explicitness in the RFPA's definition of "financial record," see supra note 29, clarifying that because "financial record" also includes information derived from financial records, both: (i) identifying customer and account information and (ii) specifics of suspected illegal activity (to the extent a transaction with the financial institution has been completed), are technically "financial records" not subject to voluntary disclosure except as specifically authorized elsewhere.

2. Standard Employed by Financial Institutions in Determining To Make Voluntary Disclosures.

We endorse the approach of H.R. 1367, which allows a financial institution to disclose information "which it believes may be relevant to a possible [law] violation." The insertion of the "it believes" language implies a subjective analysis, namely, what the financial institution actually thought. This approach is consistent with extending a good-faith defense to financial institutions making voluntary disclosures. A good-faith defense inherently should apply only to an entity that in fact believes itself to be operating within the letter of the law.

H.R. 2786's approach of allowing voluntary disclosure where the financial institution "has reason to believe" the disclosed information "may be relevant" to a possible law violation implies an objective, reasonable person, standard, which may allow after-the-fact rationalization of a disclosure. This standard might mistakenly suggest the applicability of a good-faith defense if the disclosure objectively turns out to be relevant, notwithstanding that the financial institution at the time of disclosure subjectively believed otherwise. In addition, this standard might discourage voluntary disclosure by placing financial institutions at risk where they act in subjective good faith but it is later determined that they did not have sufficient objective basis to disclose information.

3. Preemption of Conflicting State Laws.

H.R. 1367 adds language to the end of § 1103(c), covering voluntary disclosures, that explicitly preempts the provisions of any state law, constitution, or judicial decision "that is not identical to the provisions of this subsection and regulations thereunder, and that is more restrictive of disclosure to a government authority concerning a possible violation of any statute or regulation than the provisions of this subsection and regulations promulgated thereunder." H.R. 2786 adds identical language, except that it is set out as a separate section applicable to the provisions of the entire RFPA.

Neither amendment has drawn any fire, but we generally endorse the slightly narrower approach of H.R. 1367, which by focusing solely on § 1103(c), limits its preemption of conflicting state law to the voluntary disclosure situation -- the one area in which a problem has been identified by the Commission Report.[93]

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[93] As noted earlier, state courts have both applied common law notions of privacy and implied a contractual condition of confidentiality in the bank-customer relationship to proscribe voluntary disclosures. See supra p. 16 & n.35.

Notwithstanding our preference for H.R. 1367's approach here, we believe that its (as well as H.R 2786's) requirement that state law be preempted only if it is both (i) not identical to, and (ii) more restrictive than, its RFPA counterpart, may be redundant. Limiting the preemption language to those state laws that are simply more restrictive of disclosure would seem to achieve the same end.

4. Extension of Good-Faith Defense to Voluntary Disclosures.

Both H.R. 2786 and H.R. 1367, using virtually identical language, would amend the current good-faith defense residing in § 1117(c) of the RFPA to conform to the broader and easier voluntary disclosure plans they propose. We endorse this general concept. Once there is agreement on the allowable scope of voluntary disclosure, it makes sense to extend a defense to persons or institutions disclosing in good-faith compliance therewith.

We do not endorse either bill's proposed language for such an amendment, however, since we do not agree with their conception of the allowable scope of voluntary disclosure; each bill provides a good-faith safe harbor for voluntary disclosures that could include extensive revelation of a customer's financial records or information derived therefrom.

Instead, what is needed is a good-faith defense that strictly conforms to the amount of allowable voluntary disclosure under § 1103(c): namely identifying information concerning the individuals and accounts involved in, and the nature and specifics of, the suspected illegal activity. Accordingly, we would propose that § 1117(c) be redrafted along the following lines:

> Any financial institution, or officer, employee or agent thereof, making a disclosure of the financial records of a customer, or information contained in such records, pursuant to this chapter in good-faith reliance upon a certificate by any Government authority, or making a disclosure of identifying information concerning the individuals and accounts involved in, and the nature and specifics of, suspected illegal activity, in accordance with subsection 3403(c) of this Title and in good-faith belief that such identifying information is relevant to a possible violation of any statute or regulation, shall not be liable to the customer for such disclosure or for any failure to notify the customer of such disclosure. [Underlining represents additions to current § 1117(c).]

This strict linguistic cross-reference to § 1103(c) is, we believe, a necessary restriction on the scope of the good-faith defense, and makes clear that voluntary disclosure encompassing financial records beyond identifying name and account information does not qualify thereunder.

5. Customer Notification Requirements in Voluntary Disclosure Situations.

No current provision of the RFPA addresses what, if any, customer notice must be given, by either the government or the financial institution itself, when the financial institution voluntarily discloses information with respect to that customer. See supra pp. 39-40 & n.60. Both H.R. 1367 and H.R. 2786 make the deliberate policy choice of: (i) immunizing financial institutions from having to make any customer notifications by extending the RFPA's current "good-faith" defense to "any failure to notify the customer of such [compelled or voluntary] disclosure;" and (ii) not amending the RFPA to extend government notification requirements to such instances.

We endorse this approach -- but only if the amount of voluntary disclosure is strictly limited so as not to include financial records beyond identifying name and account information. See supra pp. 67-70. Not permitting notification of the affected customer at the point of initial voluntary disclosure should then only minimally infringe on a customer's privacy interests, since the information contained in a voluntary disclosure will be quite limited. More importantly, notification at this stage, assuming the instinct behind the voluntary disclosure is accurate, may, by alerting the customer, jeopardize the potential success of any investigation to follow and, if required to be made by the financial institution, deprive the government of the decision whether to seek a "no notice" order pursuant to § 1109.

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6. RFPA Applicability to Grand Jury Subpoenas: Customer Notification Requirements for Interagency Transfer of RFPA-Obtained Records.

We reject H.R. 2786's additional disclosure proposals which would: (i) eliminate customer notification requirements under § 1112 of the RFPA when interagency transfers of financial records obtained pursuant to the RFPA occur; and (ii) delete § 1120(1)'s requirement that records obtained pursuant to grand jury subpoena "be returned and actually presented to the grand jury." See supra pp. 42-43.

Both changes appear to sacrifice the considerable privacy interest in minimizing the further dissemination or exposure of one's records, without providing more than a marginal, if any, benefit, to law enforcement. With respect to interagency transfers of financial records obtained pursuant to the RFPA, customer notification requirements under § 1112 serve to heighten the awareness of persons within both the transferring and receiving agencies to the highly sensitive nature of the financial records and to the restrictions that apply to their use. Similarly, with respect to records obtained pursuant to grand jury subpoena, § 1120(1)'s requirement of actual presentment to the grand jury serves to designate formally such records as RFPA-obtained documents, thereby reminding the government of their sensitive nature and of the restrictions, both within the RFPA and Rule 6(e) of the

Federal Rules of Criminal Procedure, on their use. Therefore, to the extent that the transfer of financial records is removed from the protective penumbra of the RFPA and thereby made easier and less traceable, there is a substantially increased risk that these records will be misused by the government or that their integrity will be compromised.

7. Amendment of Rule 17(c) of the Federal Rules of Criminal Procedure.

We endorse § 4 of H.R. 2786 which proposes to amend Rule 17(c) of the Federal Rules of Criminal Procedure to clarify the authority of the district courts to issue, and set standards for the issuance of, orders commanding a person to whom a subpoena is directed not to advise, for a specified period, any other person of the existence of the subpoena.

Although this power may well already exist, certain judges and magistrates are reluctant to grant applications for such orders in the absence of express authority in a statute or rule of procedure. Some courts, as discussed earlier, see supra p. 41 & n.63, have taken the position that because the RFPA includes specific provisions for the entry of orders delaying notice to customers of the receipt of subpoenas seeking customer records, yet exempts grand jury subpoenas from the RFPA, this exemption carries with it the implication that the courts are without authority to issue "no notice" orders with respect to grand jury subpoenas.

The proposed amendment to Rule 17(c) would resolve this problem and clarify the current state of the law. Moreover, by including strict standards paralleling those in RFPA § 1109 for the issuance of such "no notice" orders, the amendment decreases the likelihood that this already-existing power will be abused. The order will only issue if the court determines both that there is reason to believe the material covered by the subpoena is the object of a legitimate law enforcement proceeding and that there is also reason to believe that notification of the existence of the subpoena will result in endangering the safety of any person, flight from prosecution, destruction of evidence, intimidation of potential witnesses, or otherwise seriously jeopardizing an investigation or unduly delaying a trial.[94]

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[94] According to the Administration's explanatory commentary accompanying H.R. 2786, this amendment to Rule 17(c) is not intended to prevent a person to whom a subpoena duces tecum is directed from exercising his or her Sixth Amendment rights to consult with counsel. In other words, the amendment would not give the court the authority to order the person not to consult with counsel. In this situation, however, the court would have the authority to order that the attorney not notify any other person of the existence of the subpoena for a specified length of time.

C. The New Receiving Crime

The Administration's proposal, H.R. 2786 § 8, would add to Title 18 a new § 2322 defining a felony called "Receiving the Proceeds of a Crime." No other bill contains this proposed new crime.

The crime actually consists of two separate offenses, the first of which applies to whoever "receives" money or property obtained in connection with "a violation of any law of the United States" that is punishable as a felony, "knowing or believing" it to have been so obtained, and the second of which applies to whoever "brings or transfers" into the United States money or property obtained in connection with a violation of "any [drug trafficking] law of a foreign country, . . . knowing or believing" it to have been so obtained. See supra pp. 43-44.

With regard to the first proposed offense defined by new § 2322, we believe that there is no evidence that begins to justify its adoption. The Commission Report nowhere even remotely suggests that this type of broadly drawn response is necessary or even desirable to deal with the problem of money laundering.

Moreover, the breadth of the proposal creates the same sorts of problems discussed in connection with the new money laundering crime proposed by H.R. 2786, including particularly the Sixth Amendment problems associated with its applicability to criminal defense lawyers. See supra note 83. Specifically, the actus reus and mens rea components of the crime are so minimal that a likely result will be to bring within its reach criminal lawyers, merchants, and others who merely provide criminal defendants with goods and services. A grocer who sells a can of tuna fish to a person under indictment for being a member of a RICO organization, for example, would appear to risk committing the offense defined by the first part of new § 2322. In this sense, a "status" crime is created, whereby any person with a reputation for being connected to organized crime may be effectively isolated from completing ordinary, day-to-day, financial transactions because the other party will fear incurring "receipt of criminal proceeds" liability.

The second offense defined by new § 2322 does not give rise to these same objections and, indeed, with certain modifications, appears to be an appropriate proposal. The Commission Report quantifies the international dimension of the drug trafficking problem, and there is no valid reason why the United States should allow itself to become a repository for drug-tainted foreign investment. Indeed, to the extent that providing a haven for such funds encourages and facilitates the operations of foreign drug traffickers, there can be little doubt that this undermines efforts to combat drug trafficking within the United States. Moreover, to the extent that one effect of the new money laundering statute may be to drive money laundering activities offshore, the importation of laundered money by narcotics traffickers is a problem that is only likely to increase with time.

Notwithstanding the foregoing, as currently written, the second offense defined by § 2322 is simultaneously both over- and under-inclusive. The primary difficulties are at least twofold, but each may be remedied.

First, the crime is limited to "whoever . . . brings or transfers" into the United States such illegally-derived assets. This language should be expanded to cover "whoever . . . brings or transfers or causes to be brought or transferred." It is likely that many of the transfers of funds one would hope to stop with legislation of this sort would be effected not by drug traffickers themselves, but by financial institutions acting on their behalf. The bill should reach foreign drug traffickers who insulate themselves by using intermediaries to "cause" transfers to be made.

Second, for the same reasons discussed in connection with the money laundering crime, see supra pp. 46-51, the mens rea requirement of "knowing or believing" is too broad. It should be limited to "knowing" transfers, so as not to create a statute too inclusive in its scope.

Finally, although the international nature of the drug trafficking industry creates a strong and substantial federal interest in being able to prosecute all foreign-based parties who aid drug traffickers to invest their profits in the United States, as a practical matter, it may be extremely difficult to reach and prosecute foreign financial institutions that facilitate this process, even if they do so knowingly. Congress may thus wish to consider, given such practical difficulties, whether the offense ought to be restricted to those persons or entities that have actually violated foreign narcotics laws.

An alternative -- and our preference -- to defining and fine tuning a "transferring" offense in a new § 2322, however, is to revise slightly the extraterritoriality provision of H.R. 2786's money laundering statute, proposed § 1956(f). Principally, what appears needed is to extend the list of predicate unlawful activities contained in (f)(1), which currently includes violations of Title 18, criminal violations of the Internal Revenue Code, drug trafficking offenses listed in Title 21, and violations of one of several espionage-type statutes, to include violations of foreign drug-trafficking laws.[95]

Conclusion

We agree with the findings of the Commission Report concerning the extent and scope of the money laundering problem. Money laundering today is a widespread and sophisticated process that contributes greatly to the success of organized criminal activities, especially narcotics trafficking. Current law enforcement tools are inadequate to redress the situation, and new legislation is needed.

We further agree with the Commission that the response needed from Congress is twofold: (1) creation of a federal money laundering offense that attacks and punishes the problem directly; and (2) amendments to the RFPA to allow freer disclosure by financial institutions of information relevant to the detection and prosecution of money laundering activities.

However, we believe that the bills that have emerged in response to these concerns, in particular the Administration's proposal (H.R. 2786), but also the Commission's proposal (H.R. 1367), are too broad in their reach and infringe unacceptably on other, substantial, societal values. Accordingly, we have recommended herein a number of ways in which to narrow the scope of the bills in an effort to address only those law enforcement problems that clearly exist.

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[95] The extent to which (f)(1) should cover anything other than strictly drug-related offenses is a separate question, see supra pp. 61-63.

COMMITTEE ON FEDERAL LEGISLATION

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The Committee gratefully acknowledges the assistance of Roger Schwed, Columbia University School of Law, Class of 1986, in the preparation of this Report.

ACLU
WASHINGTON OFFICE

122 Maryland Avenue, NE
Washington, DC 20002
(202) 544-1681

Jerry J. Berman
CHIEF LEGISLATIVE COUNSEL

National Headquarters
132 West 43 Street
New York, NY 10036
(212) 944-9800

Norman Dorsen
PRESIDENT

Ira Glasser
EXECUTIVE DIRECTOR

Eleanor Holmes Norton
CHAIR
NATIONAL ADVISORY COUNCIL

May 13, 1986

Rep. Fernand J. St. Germain
Chairman
Subcommittee on Financial Institution
Supervision, Regulation and Insurance
Washington, DC 20515

Dear Mr. Chairman:

I am writing to apologize for my inability to appear in person before your Subcommittee on May 14, 1986 to testify on money laundering legislation. After several postponements, the House Judiciary Subcommittee on courts, Civil Liberties and the Administration of Justice has scheduled a markup of the Electronic Communications Privacy Act of 1986 at which I must be present.

In my prepared statement, which I ask you to make part of the Record, I emphasize that the ACLU has no objection to money laundering legislation per se but strongly opposes the Administration proposal which would needlessly weaken the Right to Financial Privacy Act of 1978.

I am anxious to work with the Committee on this legislation and to provide any needed assistance to the Committee and its staff.

Sincerely,

Jerry J. Berman
Chief Legislative Counsel

TESTIMONY

OF

JERRY J. BERMAN
CHIEF LEGISLATIVE COUNSEL

ON BEHALF OF

THE AMERICAN CIVIL LIBERTIES UNION

ON

MONEY LAUNDERING CRIME PROPOSALS
H.R. 2785, H.R. 1474, H.R. 1367, H.R. 1945

AND CURRENCY TRANSACTION REPORTING PROPOSALS
H.R. 4573, H.R. 3892, H.R.4290

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE

OF THE

HOUSE BANKING COMMITTEE

MAY 14, 1986

Mr. Chairman and members of the Subcommittee:

Introduction:

On behalf of the American Civil Liberties Union, I want to thank you for requesting our testimony on proposed money laundering legislation. As you know, the American Civil Liberties Union is a nonpartisan organization of over 250,000 members dedicated to the defense of civil liberties guaranteed by the Bill of Rights.

We recognize that money laundering is a serious and growing problem in the United States and that legislation may be necessary to deal with it. However, we believe that any legislation in this area must be carefully crafted to balance the legitimate and demonstrated needs of law enforcement with the privacy rights and other civil liberties of bank customers and citizens. For this reason, we strongly oppose the Administration's proposal, H.R. 2785, "The Money Laundering and Related Crimes Act of 1985." H.R. 2785 is not a narrowly focused approach to the problem. Instead it is a prosecutor's "wish list" and a serious threat to civil liberties.

Our foremost objection is that H.R. 2785 would eviscerate the modest protections for customer bank records established by the Congress in the Right to Financial Privacy Act of 1978 and would preempt state privacy laws which protect bank records. We also object to the breadth of conduct made criminal under the bill because it will increase the volume of bank records which may be turned over to the government in violation of established privacy protections and could lead to the investigation and prosecution of conduct which should be considered legal. The bill would also establish new crimes which, if broadly applied by prosecutors, could adversely affect First and Sixth Amendment rights. We believe the Administration has not established on the public record a credible justification for gutting the Right to Financial Privacy Act or creating sweeping new criminal statutes in order to reach money laundering schemes. The Administration approach should be rejected.

In our testimony today, we will focus on the Administration bill because of its serious threat to civil liberties. However, we want to make it clear at the outset that we believe a balanced approach to the money laundering problem is possible. In this regard, we have no fundamental objection to the approach embodied in Rep. William Hughes bill, H.R. 1474, legislation that would make money laundering narrowly defined a crime without weakening the Right to Financial Privacy Act. If the intent of Congressman William McCollum's amendments to the Right to Financial Privacy Act in his original bill, H.R. 1367, are meant only to clarify authority which banks already have under the Act, then we would have no fundamental objection to H.R. 1367. Rep. Carroll Hubbard's proposal, H.R. 1945 falls in the same category. Our principal concern with these bills is with the requisite intent or scienter necessary for someone to commit the crime of money laundering. Finally, we have no serious civil liberties objections to proposals that would increase reporting requirements and certain penalties under the Bank Secrecy Act, H.R. 4573, H.R. 3892, and H.R. 4280.

II. Privacy Concerns Regarding H.R. 2785

As the price of living today's society, citizens must turn over extensive personal information about themselves to government and private agencies to receive benefits, obtain credit, or conduct business. Information once kept in the home and protected from intrusion by the Fourth Amendment is now held by third party record holders. Bank records are a case in point. Checking accounts, loan applications, and bank credit card transactions contain considerable personal information about our finances, tastes, opinions, and travels. Today, with computerization, these records are readily accessible for investigatory purposes.

Unfortunately, the Supreme Court has not interpreted the Fourth Amendment in a way which affords citizens privacy protection for their bank records. In 1976 the Court held in United States v. Miller that citizens had no property or privacy interest in bank records. In response the Congress passed the Right to Financial Privacy Act in 1978 to give citizens some expectation of privacy in bank records. In effect, the Congress overturned the Miller decision.

In all candor the Act is not a "model" privacy Act. When passed, it represented a compromise between privacy advocates who wanted notice and formal process each time the goverment sought individual bank records and law enforcement agencies who wanted flexibility in some circumstances. Under the Act, citizens, in most circumstances, must be notified that a a demand for his or her records has been made by the government and afforded an opportunity to contest access in a court of law.

However, there are important exceptions to the notice and challenge requirements which must be understood in the context of evaluating the merits of the Administration's proposed amendments to the Act. Notice is not required if the government obtains a search warrant and the government may obtain a delay of notice pursuant to a grand jury subpoena or from a judge if it can demonstrate that there is a possibility of physical injury to a person, flight from prosecution, destruction of or tampering with evidence, or that notice would otherwise seriously jeopardize an investigation or official proceeding. Moreover, in court the government does not have to meet a probable cause or even a reasonable suspicion standard (as required for government access to cable subscriber information in the Telecommunications Act passed by Congress in the last session) to obtain customer bank records but only that the records are relevant to an investigation.

The amendments to the Right to Financial Privacy Act contained in Section 3 of H.R. 2785 would seriously weaken the limited privacy protections in the Act without any demonstration on the public record that the Act presents a serious impediment to law enforcement investigations in general or of money laundering schemes in particular. At this point, we should look at the proposed changes in RFPA and whether there is any demonstrated justification for them.

1. Disclosure of Bank Records Without Any Process

Subsection 3(a) would add a new exception to the privacy protections of the Right to Financial Privacy Act. It would permit a bank to disclose individual customer records to the government without notice or legal process when the bank "has reason to believe" that the information may be relevant to the violation of one of a group of specific laws (i.e. when there is suspicion of a crime by or against a bank; suspicion of a drug-related offense; or suspicion of money laundering).

While this may appear on the surface as a "surgical" demand for a narrow category of bank records to meet a compelling social problem, the section actually amounts to "carte blanche" authority for the government to request and banks to turn over on their own initiative or out of fear of possible prosecution bank records in a wide variety of circumstances without notice to the customer or formal legal process.

First, the Administration's proposed crime of money laundering for which an exception is granted covers conduct far broader than what is commonly understood as money laundering activity. Although the Administration testifies about criminal elements laundering cash through banks in amounts under the $10,000 reporting requirement of the Bank Secrecy Act by buying cashiers checks, money orders, and the like (e.g. "smurfing") or more broadly transfering illegal cash into stocks, bonds, real estate, or business ventures, the scope of the money laundering offense in section 2 of the bill sweeping. The offense literally covers any person who conducts any financial transaction whether in cash or other monetary instrument "with the intent to promote...carry on...or facilitate...any unlawful activity...which in any way or degree affects interstate or foreign commerce...or conducts any transaction "knowing or with reckless disregard of the fact that such monetary instruments or funds represent the proceeds of, or is derived directly or indirectly from the proceeds of any unlawful activity." The definition of unlawful activity covers any federal or state crime punishable by a term of a year or more.

We read the crime to cover almost any crime and conduct which should not be criminal. It would cover buying drugs, illegal firearms, selling defective merchandise, fraud, embezzlement, and so on. A car salesman, a brokerage firm, a real estate company, or politican who engaged in any transaction with anyone in circumstances where they "should have known" that the money received was indirectly derived from illegal activity would also be guilty of money laundering.

While the money laundering offense raises questions of federalism and overbreadth to which we will return, in the context of an exception to the Right to Financial Privacy Act, it means extensive bank records are subject to the notice and legal process exception and may be turned over to the government. In this regard, banks are given enormous discretion to turn over records unilaterially. Section 3(a) allows a bank officer to turn over records whenever he or she "has reason to believe" the records "may be relevant" to a money laundering offense, drug crime, or violation of the Bank Secrecy Act.

The money laundering crime may even act as subtle coercion on banks to turn over records in this fashion---to avoid possible criminal prosecution in circumstances where they might be acting in "reckless disregard" of the fact that money in certain accounts was derived indirectly from illegal activity. The best way to avoid serious negligence is to check suspicions with the government by turning over bank records. One bank official has commented that while banks want to cooperate with the government in detecting illegal money laundering activity, the banks also want to protect customer privacy and not become "bank snitches." This statute is drawn in a way which may give them no other choice.

We believe this new exception to the current law is absolutely unnecessary. Present law permits a bank to release records in most circumstances only after the government has filed a proper demand and a customer is notified. However, present law does permit a bank, on its own initiative, to notify the government that it has information which may be relevant to a possible violation of the law. (Section 1103 of 12 U.S.C. 3403) The government can then obtain individual records by complying with the procedures in the 1978 Act. Moreover, as noted earlier, present law permits access to records without notice to a customer pursuant to a search warrant, grand jury subpoena, or when a court determines that notice would create danger of physical injury, tampering with evidence, or would otherwise seriously jeopardize an investigation. (See sections 1102, 1109 of 12 U.S.C. 3409)

We note that the government has made no showing that the Right to Financial Privacy Act procedures present a serious impediment to law enforcement or money laundering investigations.

In fact the GAO has reported that the Act has not slowed down investigations and that the government has rarely, if ever, invoked its right to override the requirement that a bank customer be notified when the government has access to his or her records. In a 1984 "Report on Applications for Delays of Notice and Customer Challenges Under Provisions of the Right to Financial Privacy Act of 1978" by the Administrative Office of the United States Courts, it is revealed that the federal goverment requested delayed customer notices in only 10 cases. All occured in one state, Nebraska. All requests were granted. In point of fact, the Report indicates that the federal government has filed only 30 delayed notice applications including the 10 in 1984 since the Act went into effect in 1979!

Instead of permitting banks to turn over records without process, the goverment should be satisfied if the law is clarified to indicate that banks may turn over information that may be relevant to an investigation. In this respect, section 3(c) expands the amount of information that a bank can release to the government concerning its suspicions that criminal activity is or has taken place. Currently, the Right to Financial Privacy Act permits a bank to notify the government on its own initiative that it "has information which may be relevant to a possible violation of any statute or regulation." (Subsection 1103(c) of 12 U.S.C. 3403(c)) The proposed subsection 3(c) would add clarifying language explaining that such information may include the names of individuals, the types of accounts involved, and the nature of the suspected activity. This clarifying language appears reasonable to provide banks with some guidance. But with such a change, the release of individual records permitted by subsection 3(a) becomes even more unnecessary. With subsection 3(c), the banks can give the government enough information for it to proceed in its investigations, and if the government finds that it needs specific bank records, it can get them by complying with the procedures in the Act. If it needs delay of notice, present law provides the means for obtaining it.

2. Good-Faith Defense

On top of permitting banks to turn over bank records without notice and process, the Administration also proposes to give banks a "good faith defense" to civil liability when they do so. This section is an incentive for banks to cooperate with the governnment in going around formal process and dangerous to bank record privacy. Under current law, a bank has a good faith defense against liability if it discloses information when it has the appropriate government paper work in hand. Subsection 3 (c) would provide a defense against civil liability if the bank could show records turned over without process was done in a "good-faith belief that such records may be relevant to a possible violation of law." Any violation of law. Thus, under this section, a bank may be immune from liability for releasing bank records about the Socialist Worker Party, an organization providing abortion counseling to teenagers, or a fundamentalist religious organization ---all in the "good faith belief" that their activities involve "possible violations of law." A mere request by a government investigative agency might be enough to justify a "good faith belief."

3. Exchange of Bank Records Among Different Government Agencies

Subsection 3(b) would permit financial records obtained by one government agency to be transferred to another agency without notice "if there is reason to believe that the records may be relevant to a matter within the jurisdiction of the receiving agency." The current Act permits such exchanges of customer information with only a minor paperwork requirement and subsequent notice to the customer (Subsection 1112(a), 12 U.S.C. 3412(a)) H.R. 2785 would repeal even these minor protections, once again without any public record that they seriously impede investigations. If notice to a customer will interfere with an investigation, an agency can always ask a court to waive the notice requirement. (This, as we have noted, is an authority rarely invoked). Keeping a record of exchanges among federal agencies--as required under current law--is important for accountability and to insure that these exchanges are relevant to a criminal investigation. It is also important that government observe the fair information principle embodied in the Privacy Act of 1974 and PFPA that personal information collected for one purpose should not be used for another without the subject's notice and consent. These protections should not be repealed.

4. Bypassing the Grand Jury

Subsection 3(f) would remove the requirement that the government actually present to a grand jury any bank record information it obtains through a grand jury subpoena. At first glance, this may appear as insignificant or actually a protection for the individual since it is a limitation on secondary disclosure of bank record information. In fact, the requirement that subpoened information must be presented to a grand jury was intended to safeguard against abuses of privacy. Before using a grand jury subpoena to access bank records, federal agents must be on firm grounds, since they know that in the future they _will be required_ to justify the access before a grand jury. This part of the current law seems a valuable safeguard against abuse and should not be altered.

5. Preemption of State Privacy Laws

Subsection 3(g) of the proposed Act would preempt state privacy laws which may be stricter than federal law. Again we do not think the government has shown that these state laws impede the investigations of bank fraud, or any other crimes. It seems therefore, that it is an unnecessary intrusion on the states to preempt their laws and a further erosion of bank record privacy. The subsection, if enacted, would wipe out statutes in Alaska, California, Connecticut, Louisiana, Maryland, New Hampshire, Oklahoma, and Florida.

6. Wiretaps

An additional privacy concern is that H.R. 2785 proposes to add the crime of money laundering as defined as one of the offenses for which electronic surveillance is authorized under Title 18 U.S.C. 2510 et. seq. The American Civil Liberties Union opposes all wiretapping as a general search under the Fourth Amendment. While the courts and Congress may not agree with us, the Congress has recognized the intrusiveness of wiretapping and it should not be used indiscriminately. The statute authorize's it for particular crimes punishable under federal law.

Because of the scope of the money laundering crime discussed above, adding the proposed section 1956 as a wiretapping offense would vastly expand federal wiretapping authority to cover a significant number of crimes up to now exempted from the wiretap authority of Title III. They would now be subject to wiretapping by federal law enforcement agencies under the "money laundering" offense. We object in principle to adding any crimes under the Safestreets Act. If Congress adopts the Administration's definition of money laundering, which we oppose, we urge it not to add it to the crimes covered by the federal wiretap statute.

II. Breadth of the Money Laundering Crime

Independent of our concerns about bank record privacy, we urge the Congress to consider the possible overbreadth of the mon / laundering crime proposed in H.R. 2785 and the wisdom and even constitutional difficulties posed by the enactment of such a sweeping criminal statute. As stated earlier, this bill does not only apply to cases where cash is laundered through a bank. It applies to any monetary transaction involving the movement of funds that affects interstate commerce conducted with the intent to facilitate any unlawful activity or with the knowledge or reckless disregard of the fact that the money was derived from illegal activity. It is not limited to cash transactions but applies to any "monetary instrument, including cash, traveler's checks, personal checks, bank checks, money orders, investment securities, gold or precious coins, and negotiable instruments in bearer form. A host of issues are posed:

First, there is the issue of federalism. Under this statute, federal agencies would be able to investigate and prosecute as "money laundering" a myriad of crimes usually left to state and local authorities. The purchase of drugs, the sale of a handgun, real estate swindles, garden variety extortion, or misrepresentation in the sale of a used car could be reached under section 1956.

Second there is the problem of overbreadth which might affect protected constitutional rights. For example, a retainer received by a criminal defense lawyer might subject the lawyer to possible criminal prosecution for engaging in a money transaction knowing or in "reckless disregard" of the fact that the funds were derived directly or indirectly from illegal activity. An investigation and prosecution in such circumstances poses Sixth Amendment Right to Counsel as well as Attorney Client Privilege issues. The example, given recent prosecutorial efforts to seek "forfeiture" of attorneys fees paid in drug cases, is not farfetched.

We note in this context that section 9 of the bill amends Title 18 of the United States Code by adding a chapter dealing specifically with forfeitures. This section provides for both criminal and civil forefeitures of money involved in money laundering, money or property traceable to money laundering, and where this money or property cannot be located or has been transferred to a third party. The same Sixth Amendment issues raised in the context of the current forfeiture statute would be exascerbated under this legislation.

Applications of this statute could have a "chilling effect" on protected First Amendment activity. For example, it could be a crime for a candidate to receive money from certain unions if the candidate should have known that the union was involved in illegal activity or if leaders of the union had some connection with organized crime figures. Could a congressional investigation or a report by the President's Organized Crime Commission about certain union officials or corporate executives put politicians at peril if they accepted PAC money from them? Is this statute a potential basis for even more intrusive, even politically motivated versions of Abscam?

While we would expect federal agencies to use "discretion", it would be wiser to enact a narrow statute which addressed money laundering through financial institutions perse; one that indeed established a more direct way to investigate and prosecute such schemes than reliance on the Bank Secrecy Act but avoided the potential pitfalls of the Adminstration proposal. We believe this is the intent of Chairman Hughes in introducing H.R. 1474 and why we do not oppose his bill or other bills which make money laundering a crime but leave alone the provisions of the Right to Financial Privacy Act.

III. Other Crimes

At the outset of our testimony, we described the Administration proposal as a prosecutor's"wish list" rather than a balanced approach to the problem of money laundering. The first proof of this is the scope of the money laundering crime. The second is the unnecessary amendment of the Right to Financial Privacy Act. The third is that section 8 of the bill also establishes a crime of "facilitation" and a new offense of "receiving the proceeds of a crime."

These are crimes of general application and may have sweeping and dangerous applications. We believe the crime of facilitation goes far beyond established concepts of criminal *mens rea* and is both overbroad and vague. Does a bus company facilitate a crime by bringing demonstrators to Washington who are planning to engage in civil disobedience? Does a hotel facilitate a crime by making space available to alleged mafia figures who use the facility to plan a crime?

The crime of receiving the proceeds of a crime would punish anyone who received such proceeds knowing or *believing* the same has been obtained in violation of law. Are employees of E.F. Hutton or a defense contractor found to have violated the law guilty of a crime for taking home their paychecks because they believed the money was derived from illegal activity?

Conclusion

In conclusion, Mr. Chairman, we have today focused our testimony on the Administration bill, H.R. 2785 and principally on how it would adversely effect bank record privacy. However, we believe the legislation deserves close and broad scrutiny on a range of issues posed by various other sections of the bill.

As we said at the outset, we believe money laundering is a problem but that a balanced approach which meets law enforcement needs without violating civil liberties is necessary. H.R. 2785 is not balanced and constitutes a serious threat to civil liberties. We urge its rejection and that the Congress proceed with more narrowly drawn legislation that indeed strikes a just balance between competing and compelling public interests.

STATEMENT OF EUGENE T. ROSSIDES
REGARDING MONEY LAUNDERING PROPOSALS
TO THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE OF
THE COMMITTEE ON BANKING,
FINANCE AND URBAN AFFAIRS OF THE
HOUSE OF REPRESENTATIVES

MAY 14, 1986

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to express my views on the various money laundering bills now being considered by Congress. I address this issue from the somewhat unique perspective of having dealt with the Currency and Foreign Transactions Reporting Act of 1970 ("Act") from both sides of the regulatory fence. From 1969 to 1973 I served as Assistant Secretary of the Treasury for Enforcement, Tariff and Trade Affairs and Operations. In that position I presented the views of the Treasury Department and the Administration to the House and Senate Banking Committees which considered the Act when it was proposed in 1969. Following its enactment, my responsibilities included the enforcement of the Act. In my present capacity as a partner in a law firm in Washington, D.C. I represent a major U.S. banking institution. I also serve as a director of a national bank. These banks are committed to doing all they can to fully carry out their responsibilities under the Act but at the same time are concerned about protecting the trust of their law abiding customers -- a trust which is the linchpin of our domestic banking industry and which depends so importantly upon individual privacy, which has been increasingly encroached upon by government actions. I therefore appreciate the opportunity to present my views on this important issue.

As the recent Congressional hearings have underscored, money laundering is an important complement to drug trafficking and other criminal activity. While efforts thus far to abate money laundering have had serious limitations, Congressional and media attention to the subject over the past year have produced a high level of vigilance in financial institutions and a high level of consciousness among enforcement officials. In general, this has been an altogether salutary development.

Nevertheless, I perceive as troublesome certain aspects of the current debate about money laundering legislation.

First, while money laundering is a serious problem that must be vigorously addressed, it does not necessarily follow that imposing broad new requirements upon banks will solve the problem. Second, I become concerned when I see the law enforcement community shifting its focus away from drug traffickers and others in organized criminal groups and preoccupying itself with reporting failures by banks. While some banks have been less than diligent in meeting their filing obligations under the Act, I think William Nickerson, former Deputy Assistant Secretary of the Treasury for Enforcement, was directly on point recently when he observed that the government had "misenforced" the law by prosecuting bankers instead of narcotics dealers and other money launderers and that "what we've seen is a loss of understanding of the purpose of the act."1/ While the recent Congressional attention given to enforcement of the Act has been commendable, the Congress should not in the process allow the law enforcement community to escape critical review and scrutiny for its own singular failure to effectively combat drug trafficking.

The Currency and Foreign Transactions Reporting Act of 1970

To understand the application of the Currency and Foreign Transactions Reporting Act of 1970, often referred to as the "Bank Secrecy Act", one must recall the purpose for which it was enacted. With direct authority over the U.S. Customs Service and Secret Service, as well as policy supervision regarding IRS criminal enforcement, I, along with other law enforcement officials, supported passage of the Act as a useful tool to augment existing criminal investigations. The data to be retained by the banks under the Act was to provide a source of information to bolster or help direct ongoing investigations of targeted suspects and future specific investigations. It was created to ensure that documents relevant to a particular suspect remained available for the use of investigators and prosecutors. The Act's target was the alleged criminals being investigated, not the banks. The reporting requirement established pursuant to the Act was, in general, a continuation and alteration of then existing reporting requirements.

The Act was passed only after Congress took the time to strike a balance of the needs of law enforcement with the administrative burdens the recordkeeping and reporting requirements imposed on financial institutions. The Act was viewed by those in law enforcement, the financial industry and the Congressmen and Senators who passed it as primarily a recordkeeping and record retention law. Indeed, its provisions are contained in the United States Code under the heading "Records and Reports on Monetary Instruments Transactions." The Act did not establish and was never understood to have established a relationship between financial institutions and government whereby banks would be required to conduct surveillance on their customers and report the slightest suspicious transactions to government agencies. Such a concept is alien to our system of law and justice.

Application of the Act Over the Last 15 Years

After conducting a thorough investigation of utilization of the data gathered under the Act, the Comptroller General reported to Congress in 1981 that "the reports required under the Act are not widely used and their potential utility as an investigative tool is unknown."[2] The Comptroller General concluded: "After 10 years, the Bank Secrecy Act has not been used sufficiently to demonstrate whether the demands it places on the private sector, especially financial institutions, are commensurate with the benefits obtained by the Federal Government."[3]

Although the Comptroller General's report put the agencies on fair notice as to the lack of adequate utilization of currency transaction reports ("CTRs") and related documents, the banking industry was not made aware of any substantial failure of compliance on its part. Thus, the Comptroller General reported that according to the bank regulatory agencies in 1981, "fewer than 2 percent of financial institutions fail to comply with the reporting requirements."[4] While the fact that the government was seemingly satisfied with the banking industry's compliance with the Act is not an excuse to become complacent about the reporting requirements, it was certainly evidence of the relative lack of importance the government placed on the reporting requirements imposed under the Act.

In the intervening four years between the 1981 GAO report and public revelations of the Bank of Boston situation, the federal government did little to alert the financial industry to any serious compliance problems. As reported to Congress on October 29, 1985 by William J. Andersen of the General Accounting Office, a then recently commissioned study demonstrated that the agencies "have given Bank Secrecy examinations a relatively low priority."[5] The study showed the agencies had allocated insufficient resources to this area, used relatively inexperienced examiners, failed to establish sufficient procedures for compliance examinations, and failed to adequately document their examinations. GAO found a lack of communication and coordination between the Treasury Department, charged with enforcement of the Act, and the regulatory agencies, whose task it was to determine adequate compliance.

With limited exceptions, such as in south Florida, the majority of banking institutions apparently believed they were complying with the reporting requirements. By 1985, however, it became clear that the government's lack of emphasis on currency reporting requirements was apparently being mirrored by some financial institutions which were charged with filing CTRs. The recent rash of fines imposed on some of the banking industry's larger members evidences what in fact was a less than total commitment by the industry as a whole. Thus, for the first time the industry was awakened to its less than exemplary record of compliance with the Act.

Present Application of the Act

While there has been an obvious lack of emphasis on the reporting requirements from both government and industry, recent events starting with Operation Greenback have turned this situation around. The importance of full compliance with the reporting requirements has been brought home to financial institutions through the substantial penalties levied against several institutions as well as the heightened Congressional and media attention paid to the money laundering problem. Fortunately, both government and the financial industry have reacted positively and have instituted actions to take the steps necessary to ensure full compliance with the Act.

A large number of banking institutions recently conducted reviews of their own procedures for the filing of CTRs. This has resulted in a marked increase in the number of CTRs filed -- from 700,000 in 1984 to approximately 2,000,000 in 1985 and an estimated 3,000,000 in 1986.[6] The increase in filings has necessitated a 500% increase in the IRS staff required to process the forms.[7] Additionally, many institutions have implemented new procedures to train their tellers and other personnel on the completion of CTRs. A number of banks have created new internal audit procedures to ensure compliance and some have hired compliance officers to oversee their reporting operations. Officials from some 6,200 banks have viewed a Department of Justice educational tape on money laundering techniques. As pointed out by U.S. Assistant Attorney General Stephen Trott, the American Bankers' Association is actively promoting the education of bank employees regarding money laundering and compliance with reporting requirements.[8]

The agencies, too, have taken steps to ensure stepped-up compliance with the Act. For example, until recently the banks themselves decided which of their customers could be deemed exempt from reporting requirements. A small number of banks routinely submitted their exemption lists voluntarily to Treasury for its review due to the uncertainty of who was entitled to an exemption. Under a regulation made effective January 1, 1986, exemptions from reporting requirements are now subject to review by the IRS.[9] Recent regulatory changes have also brought casinos under the ambit of the reporting requirement.

The government has also established or put new emphasis on data retrieval programs to make more effective use of the information collected, such as the Treasury Financial Law Enforcement Center in Washington, D.C., involving specialists from the IRS, Customs, FBI, DEA, and Justice Department.[10] The agencies have instituted new examination procedures geared toward a more comprehensive review of compliance with the Act and have established an Interagency Working Group to help ensure coordination among the various agencies involved in this area.[11]

Instead, however, of taking the time to properly review the results of this new heightened enforcement of existing provisions of the Act to determine if the benefits to law enforcement justify the burdens placed upon the government and the banking industry, bills have been submitted to Congress which threaten to stretch this recordkeeping, document retention and reporting law beyond its logical limits. These bills would impose even greater demands on the industry without a correlative benefit to government. The bills presented to Congress threaten to distort the Act into something it is not, was never intended to be, and should not become.

Proposed Amendments to Title 12 - Right to Financial Privacy Act ("RFPA")

As a former supervisor of Treasury law enforcement agencies with jurisdiction over this area, I am well-acquainted with the importance of government having reasonable access to the financial records of suspected drug dealers and other criminal elements. That is why during my tenure at Treasury I initiated efforts in 1969 to do something about Swiss bank secrecy, which led to a treaty with Switzerland to assist U.S. enforcement particularly in organized crime cases.

I also initiated and supervised a federal program directed at the illegal profits of the drug traffickers, the Treasury/IRS Narcotics Trafficker Tax Program ("NTTP"), which focused on the financial and tax records of suspected drug dealers. In only 17 months, from July 1, 1971 through December 31, 1972, the program resulted in 1,175 major drug dealers coming under full net worth tax investigation and tax action taken against 1,239 minor traffickers. Collection and seizures amounted to $15,625,792, which amount exceeded the cost of the program. (See Exhibit "A" - The Twelve Month and Seventeen Month Reports issued by the Treasury Department, Office of Law Enforcement). By prosecuting violators under the Tax Code, this highly successful and cost-effective program resulted in the indictment, conviction and imposition of fines on unprecedented numbers of drug traffickers and disruption of their operations. Unfortunately, that program was phased out after I left Treasury. It should be revived if we are serious about effective and cost-efficient law enforcment against drug traffickers.

The importance of financial information to a specific criminal or civil investigation does not, however, warrant transforming the banks into an arm of the federal prosecutor. This is precisely what the proposed amendments to the Right to Financial Privacy Act contained in the bills presented to Congress would do.

Reacting to the Supreme Court decision in United States v. Miller, which held that a customer of a financial institution has no standing to contest illegal government access to his bank records, Congress in 1978 debated long and hard -- more than 100 privacy bills were introduced and more than 40 days of hearings were held in the House alone -- on the Right to Financial Privacy Act. What was debated for so long was how to permit maximum law enforcement use of financial records while protecting the rights of citizens to entrust their money to a financial institution with the knowledge that their personal financial records would not be turned over to the government without a legitimate reason. Both the majority and minority House reports recognized this balancing of interests as the primary focus of the RFPA:

> Title XI is intended to protect the customers of financial institutions from unwarranted intrusion into their records, while at the same time permitting legitimate law enforcement activity. Therefore, the title seeks to strike a balance between customers' rights of privacy and the need of law enforcement agencies to obtain financial records pursuant to legitimate investigation. [Majority Report]

* * *

> Against the needs of the government, it is necessary to balance the need for privacy of each individual. A delicate balance must be struck because claims on both sides are legitimate. [Minority Report][12]

Congress should not now, in the name of the admirable goal of reducing money laundering and the drug trafficking intertwined with it, act too hastily and destroy that delicate balance it reached in 1978, particularly when there is little or no proven benefit to be derived therefrom. The rights of the overwhelming majority of bank customers who engage in proper and legal transactions should not be abrogated simply because prosecutors are able to relate to this Subcommittee several stories about the "one who got away". In this regard, I want to express my full agreement with the sentiment you expressed, Mr. Chairman, during the recent hearings of this Subcommittee that "we must tread very softly" in this area.

The RFPA, in its present form, already allows the government to: (1) obtain a customer's financial records pursuant to a court order, judicial or administrative subpoena or, under certain circumstances, simply a formal written request to the financial institution; (2) delay the bank's notice to the customer of the inquiry if there is reason to believe the notice will lead to tampering with evidence, flight from prosecution or otherwise seriously jeopardize an investigation of criminal conduct; (3) receive information voluntarily provided by financial institutions regarding the possible violation of a criminal statute; and (4) share with another agency financial records which are relevant to a legitimate law enforcement inquiry of that agency.

The bills seeking to amend the RFPA, such as H.R. 1367, 2785 and 2786, relax the standards under which banks are to provide the government with information about their customers and increase the information and records to be provided. In combination with the proposed amendments to Title 18 of the U.S. Code which would subject banks and their employees to criminal prosecution for conducting a transaction in which there was any reason to believe the funds were illegally derived, the proposed changes to the RFPA would force banks into the untenable position of spying on the very customers whose trust is essential to their survival. Financial institutions would be forced to report transactions involving the slightest suspicious behavior, for fear of being prosecuted for engaging in a money laundering transaction. Thus, the proposed amendments to Title 12 subvert one of the main purposes of the RFPA, which, as stated by Congressman Whalen, co-sponsor of the principal bill finally enacted, was to "restore the record holders, the banks and credit card companies, to their proper role as impartial custodians of records."13/

Additionally, the Administration's bill would allow government agencies to trade financial records in the event they "may be" relevant to a matter simply within the agency's jurisdiction. This new power would turn traditional notions of law enforcement on their head. Agencies could trade information on our everyday financial transactions until they find or create some reason for an investigation. Such an Orwellian atmosphere in which our financial transactions are subject to daily review by the government is an intrusion of privacy rights of the highest order.

There is simply no precedent for the type of unwarranted governmental power which would result from the proposed amendments. I do not believe it to be an exaggeration to state that if the procedures proposed in the Administration's bill are enacted, the trust upon which banking institutions depend so dearly will be severely damaged. Banks would in effect become assistant prosecutors or at the very least well-placed snitches who keep tabs on the local citizenry. If the public comes to believe that their bank on the corner is acting as a conduit of information for a host of government agencies, many upstanding citizens may find alternatives for retention of their funds.

The requirements Congress put in the RFPA are reasonable and the minimum necessary for protection of our privacy. These Congressionally created "obstacles" are no greater than Miranda warnings or probable cause and warrant requirements or other limitations on the prosecutor which are designed to protect the vast majority of law-abiding citizens. For instance, each and every time federal law enforcement officials have sought to delay notification to the bank customer that his records were being obtained, that request has been granted. The government, however, has made little use of this provision, seeking a delay of notification only 48 times since 1978.14/ The loss of confidence that further encroachment on our privacy may entail is too high a price to pay when the new stepped-up compliance with the Act, as it presently exists, has already resulted in significant increases in the filing of CTRs.

Proposed Amendment to 18 U.S.C. -- Making Money Laundering a Crime

Although there is a respectable body of opinion that current law provides adequate bases for dealing with money laundering, there appears to be need of a statute punishing individuals who knowingly and intentionally participate in the laundering of illegally derived funds. We must be careful, however, not to create a law whose effect will be to punish the innocent bank teller or official who is unsuspectingly made a party to the money laundering scheme or the bank with a faithless teller or official. For this reason, Congress should reject any money laundering legislation which imposes criminal liability on bank personnel for anything less than knowledge that the transaction they are handling involves illegal funds and specific intent to engage in that transaction for the purpose of laundering those funds. Unfortunately, none of the bills presently before Congress impose such a standard.

The application of criminal penalties under the "reason to know", "reckless disregard" or "substantial risk" standards which appear in the bills is not only unfair but also unworkable. These bills would question whether the teller had "reason to know" if an otherwise perfectly proper and everyday transaction involves money from some other illicit transaction, which occurred at some earlier time, at some other place at which the teller was not present. The problems in applying such a standard are obvious, especially given the fact that most tellers have only a high school education and typically remain in the job less than a year.

When does a teller have "reason to know" or act with a "substantial risk" that an otherwise normal transaction involves tainted funds? What if an ex-convict deposits $5,000 in cash? Must a teller file a report when an individual under indictment for embezzlement obtains a cashier's check for $6,500? What if one teller read the story in the newspaper about the indictment and another teller did not? Are they held to different standards? What if a customer buys a new car and starts dressing in more expensive clothes? Would a teller have to report all transactions close to but under $10,000? How close? $9,800? $9,000? $8,000? Must a teller report the transaction of a customer rumored in the neighborhood to be involved in organized crime? What if it merely involves a $150 deposit?

Additionally, what is the teller to do if he or she actually suspects the transaction to involve illegally derived funds? Under most of the bills it would be illegal for the teller to engage in the transaction. Thus, the teller would be forced to confront the alleged money launderer. This would, of course, result not only in warning the alleged criminal that his actions will be reported to law enforcement officials, but also place the teller in a potentially dangerous situation. Moreover, when the overly suspicious teller -- which is exactly what these bills would force the teller to become -- confronts an individual who is innocently engaged in a legal and proper transaction, the bank is placed into the role of accuser and thereby risks losing its customers as well as impairing the long term trust of those individuals in financial institutions in general.

These bills turn the emphasis from the criminal activity of the drug dealer to the bank teller -- to the average law abiding man and woman. That was never the purpose of the Act and never should be. We should not allow the federal law enforcement community's attention and efforts to be diverted from targeting drug dealers to targeting bank tellers and banks. I am not aware that we did not have a sufficient number of drug dealers and others in organized crime as targeted individuals. We do not need prosecution of tellers on weakened or no standards of intent to give the impression that we are succeeding in drug law enforcement.

For these reasons, if Congress decides to enact a money laundering statute, it should be limited to the real targets, those who intentionally and knowingly engage in transactions involving criminally derived funds for a criminal purpose. Such a standard would encompass the bank teller or official who acts with criminal intent without refocusing the emphasis from the criminal activity of the drug dealer, where it should be. While Congressman Hughes' bill, H.R. 1474, comes closest to the necessary standard, it does not include the "intent" standard necessary to protect the teller who, with no intent to launder funds, conducts a transaction with funds he or she suspects were derived illegally but for fear of personal safety, or to avoid embarrassing a long time customer who is in fact not laundering funds, does not confront the individual.

Proposed Amendments to Title 31 -
The Currency and Foreign Transactions Reporting Act

As has been amply demonstrated in the Congressional hearings, the recent problems associated with the Act were due to a lack of administration, enforcement and compliance with existing regulations, and not to the lack of an existing legislative or regulatory framework. The creation of new reporting requirements will serve only to hinder the process that is already in existence, which now is being properly applied. During a time of personnel cutbacks in government agencies, the IRS must now process between three and four times the number of transaction reports it handled in 1984. Indeed, both former Assistant Treasury Secretary John M. Walker, Jr. and present Assistant Secretary Francis A. Keating, II reported to Congress that they would not favor lowering the $10,000 limit for filing CTRs, citing the already monumental task facing the IRS in processing the forms they now receive.[15]

Instead, the solution is to ensure compliance with existing laws and regulations and to encourage coordination and communication both among the government agencies and between those agencies and financial institutions. The interest of the banking industry in working to stamp out money laundering is not motivated merely by a fear of being fined or avoiding negative publicity. Banks in this country, as you well know, cannot survive without the trust of their customers. No bank wishes to tarnish its reputation and jeopardize the trust of its customers by accepting illegally derived funds. Thus, a coordinated joint effort between government and industry, could result in the type of law enforcement advances which Congress and all parties involved are interested in achieving.

Just one example of how coordination between government and industry could prove beneficial was recently suggested to Congress by Treasury Assistant Secretary Francis A. Keating, II.[16] Presently, currency transaction reports must be submitted on official IRS forms. If, instead, the agencies and the financial institutions could work together to permit bank generated computerized forms, which would contribute to speed and efficiency, everyone would benefit. Such coordination might even result in the establishment of a computer network where the information could be fed into IRS data systems directly from the banks. (At present the IRS has some 310 employees processing the CTR forms so that they can be fed into the Treasury Enforcement Communications System (TEC) of the U.S. Customs Service.)[17] The information could be entered by the banks more quickly and accurately and at less cost, the data could be received and filed with expedition, and law enforcement officials would have easier and earlier access to the data for whatever value it may have.

Thus, rather than inundating both financial institutions and the agencies that regulate them with increased administrative requirements, cooperation on the best methods to apply already existing administrative requirements will provide better results and at less cost to government and industry. It is simply unfair and imprudent to impose an adversarial atmosphere through such proposed amendments as a $10,000 fine for the mere negligent failure to file a single CTR. An automatic $10,000 fine for the mere negligent failure to file a few CTRs is totally out of proportion to the conduct being punished.

CONCLUSION

If Congress enacts a statute making money laundering a crime, it should be limited to and directed at the real targets, namely individuals who knowingly and intentionally participate in the laundering of illegally derived funds. Otherwise, what is required is not further regulation or new laws, but rather further cooperation between government and industry to make the Act and other available enforcement tools useful instruments in the war on drugs. Instead of acting to gut the privacy protections Congress has afforded to individuals, or to greatly increase the administrative burdens of both the industry and the agencies, all concerned should continue to open up channels towards cooperation and take time to assess what the improvements over the last year have done to combat the money laundering problem.

The proposed amendments to Titles 12 and 31 are not only counterproductive to the goal of abating money laundering but are also imprudent. In this time of fiscal austerity under Gramm-Rudman-Hollings, the proposed bills threaten to appropriate funds and manpower in the least productive manner and further lessen our ability to require that the law enforcement community concentrate on the real targets. This would be particularly wasteful and improvident at a time when the banking agencies must devote so many of their resources to the supervision of failed and failing financial institutions. Much more productive use of funds could be made, for instance, by reinstating the low cost yet highly successful Treasury/IRS Narcotics Trafficker Tax Program (NTTP) which resulted in the indictment, conviction and fining of large numbers of drug dealers and disruption of their operations. The NTTP concentrated on the ill-gotten gains of drug traffickers but did so in an administratively workable manner utilizing bank records retained under the Act.

Congress should continue its oversight activities which have greatly contributed in the last year to strengthening the emphasis and utilization of the Act. Time should be taken to allow the increased attention paid to the Act and increased enforcement activities to be evaluated. At that time Congress will be in a better position to evaluate the cost effectiveness of the program and to properly balance the need for additional legislative requirements against the increased administrative burden such requirements will place on the agencies and the financial industry as well as the increased government intrusion into the privacy rights of our citizens.

Congress should give priority to oversight activities on the programs and operations of the various Federal enforcement agencies with the aim of determining the best methods of combatting organized crime, with particular emphasis on drug trafficking, since that overall effort has been patently unsuccessful. The priorities of federal drug enforcement should be re-examined. The federal organizational arrangement and interrelationship should be reviewed. For instance, the Customs Service -- the agency with anti-smuggling experts and a worldwide network of sister customs agencies -- is presently not authorized to investigate and handle drug smuggling cases. Congressional review should examine the best way to get at the illegal profits of drug traffickers. For instance, should the government put scarce resources into reviving the Treasury/IRS NTTP or into additional personnel for processing CTR's? Such a review should also examine the federal, state and local drug enforcement relationship, responsibilities and priorities.

These are some of the important issues that must be addressed if we are to improve our enforcement efforts against drug traffickers. While the banking industry must be prepared to do its part to combat money laundering, Congress should not allow the federal law enforcement community to divert its attention and reorder its priorities away from drug traffickers and towards bank tellers, other bank officials or banks themselves on weakened or no standards of knowledge and intent to give the impression we are succeeding in drug enforcement.

Thank you, Mr. Chairman.

FOOTNOTES

1/ Remarks of William Nickerson before the 21st Annual Banking Law Institute, May 1, 1986, as reported in BNA, *Daily Report for Executives*, May 2, 1986, p. A-17.

2/ Comptroller General's Report to the Congress, "Bank Secrecy Act Reporting Requirements Have Not Yet Met Expectations, Suggesting Need for Amendment," July 23, 1981, p. iv.

3/ *Id*. at iv.

4/ *Id*. at ii.

5/ Testimony of W. J. Anderson, Director, General Government Division, GAO, before the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, Oct. 24, 1985, pp. 5-6.

6/ Testimony of Richard C. Wassenaar, Assistant Commissioner (Criminal Investigation), IRS, before the Subcommittee on Financial Institutions of the Committee on Banking, Finance and Urban Affairs, United States House of Representatives, April 16, 1986.

7/ *Id*.

8/ Testimony of Stephen Trott, Assistant Attorney General (Criminal Division) of the U.S. Department of Justice before the Financial Institutions Subcommittee of the Banking Committee, United States House of Representatives, April 23, 1986.

9/ IRS Memorandum of Understanding, IR 85-125.

10/ Houston Post, p. 22, December 12, 1985.

11/ Testimony of Assistant Secretary for Enforcement, U.S. Dept. of the Treasury, Francis A. Keating, II, before the Subcommittee on Financial Institutions of the Committee on Banking, Finance and Urban Affairs, United States House of Representatives, April 17, 1986.

12/ House Report No. 95-1383, p. 33, U.S.C.A.N. p. 9305, *id*. at 246, U.S.C.A.N. p. 9375.

13/ 124 Cong. Rec. 33311 (October 3, 1978).

14/ BNA Report No. 92, p. A-5 (May 13, 1986).

15/ Testimony of John W. Walker, former Assistant Secretary for Enforcement, U.S. Dept. of the Treasury, before the Joint Subcommittee, March 5, 1985. Keating testimony, *supra*.

16/ *Id*. at 4.

17/ Testimony of Brian Bruh, Director of the Office of Investigations (Criminal), IRS, before the Senate Committee on Banking, Housing and Urban Affairs, May 1, 1986 and subsequent telephone discussion.

EXHIBIT A

Twelve Month Report of the Treasury/IRS Narcotics Trafficker Tax Program

During the first year of operation--July 1, 1971, to June 30, 1972--the Treasury/IRS Narcotics Trafficker Program has accomplished the following:

1. 793 major targets in 40 states, 53 metropolitan areas and the District of Columbia were selected by Treasury's Target Selection Committee and referred to the IRS for intensive tax investigation (see attached Table I). Under the direction of IRS Commissioner Johnnie M. Walters, 410 Treasury Agents and 112 support personnel are presently conducting the intensive tax investigations. In addition, 565 minor traffickers are under tax action.

2. $54.2 million in taxes and penalties have been assessed under the program, of which more than $8.5 million has already been collected in the form of cash or valued property. This is $1 million more than the $7.5 million appropriated for the program by Congress. We are now using the drug traffickers' illegal profits to put them out of business (see attached Table II).

3. Six men have been convicted on criminal tax charges; 15 other criminal tax cases are pending in Federal District Courts in New York, Miami, Detroit, Los Angeles, San Francisco, Indianapolis, Baltimore, and Washington, D.C.; and another 35 investigations have been completed with prosecution recommendations. Investigations were completed in an additional 78 cases with civil assessments and penalties determined in 64 cases.

We believe this represents a substantial achievement. By focusing attention on the persons responsible for the narcotics distribution, this program is making a major additional contribution to the President's offensive against drug abuse.

The word for the drug traffickers is to get out of the illegal drug traffic or face up to intensive tax investigation. This word should be spread in every city and town in the United States. We have institutionalized this program. Everyone in this illegal business should realize that they will be subjected to tough tax scrutiny.

The program's objectives--to take the profit out of the illegal traffic in narcotics and thereby further disrupt the traffic--are accomplished in two ways:

1. Major targets: by conducting systematic tax investigations of middle and upper echelon narcotics traffickers, smugglers, and financiers. These are the people who frequently are insulated from the daily operations of the drug traffic through intermediaries.

2. Minor targets: by the systematic drive underway to seize--to be applied to taxes and penalties owing--the substantial amounts of cash that are frequently found in the hands of minor narcotics traffickers--those below the middle and upper echelon level.

Computers are now being used in this program to facilitate the year in, year out scrutiny of the finances of these narcotics traffickers. By computerizing our information, we will be able to examine systematically and quickly each major and minor trafficker targeted under this program.

Although all of the penalties and taxes that have been assessed may not be collected, the impact of this program on the narcotics traffic is already substantial and increasing each month.

TWELVE MONTH REPORT

TABLE I

STATE	METROPOLITAN AREAS	TARGETS	COMPLETED INVESTIGATIONS
Alabama	Mobile	2	
Alaska	Anchorage	1	
Arizona	Phoenix-Tucson-Yuma	35	4
Arkansas	Little Rock	2	
California	Los Angeles-San Diego	39	10
	San Francisco-Oakland	33	3
Colorado	Denver	8	
Connecticut	Hartford	12	3
Delaware	Wilmington	1	
District of Columbia	Washington	17	4
Florida	Miami	64	17
Hawaii	Honolulu	10	2
Georgia	Atlanta	19	6
Illinois	Chicago	40	7
	Springfield	4	
Indiana	Indianapolis	8	2
Louisiana	New Orleans	12	4
Maine	Bangor	1	
Maryland	Baltimore	6	1
Massachusetts	Boston	12	1
Michigan	Detroit	53	6
Minnesota	St. Paul- Minneapolis	2	
Mississippi	Gulfport	1	
Missouri	St. Louis-Kansas City	10	2
Nevada	Las Vegas	3	

STATE	METROPOLITAN AREAS	TARGETS	COMPLETED INVESTIGATIONS
New Hampshire	Portsmouth	2	1
New Jersey	Newark-Camden	52	6
New Mexico	Albuquerque	9	2
New York	Albany	4	
	Buffalo	9	
	New York City & Suburbs	130	30
North Carolina	Greensboro-Charlotte	16	1
Ohio	Cincinnati-Dayton	9	
	Cleveland	7	
Oregon	Portland	11	1
Pennsylvania	Philadelphia	40	1
	Pittsburgh	15	5
Rhode Island	Providence	1	
South Carolina	Columbia	5	1
Tennessee	Nashville-Memphis	5	
Texas	Austin-Houston-El Paso	41	11
	Dallas	3	1
Utah	Salt Lake City	2	
Virginia	Richmond-Norfolk	24	
	Arlington-Alexandria		
Washington	Seattle	11	2
West Virginia	Parkersburg	1	
Wisconsin	Milwaukee	1	
		793	134

Treasury Department
Office of Law Enforcement

June 30, 1972

TWELVE MONTH REPORT

TABLE II

Major Target Assessments:	Number	Amounts
Regular Assessments	18	$ 4,373,126
Jeopardy Assessments 1/	19	18,764,281
Tax Year Termination Assessments 2/	23	7,974,616
Total	70	$31,112,023
Minor Target Assessments: 3/		
Jeopardy Assessments	36	$ 863,712
Tax Year Termination Assessments	529	22,256,438
Total	565	$23,120,150
Total Assessments involving Narcotic Traffickers		$54,232,173

Seizures involving Narcotic Traffickers:

	Major Targets	Minor Targets	
Currency	$ 1,763,213	$ 5,449,923	$ 7,213,136
Property	86,738	1,249,828	1,336,566
Total Dollars Seized			$ 8,549,702
Cases Recommended for Prosecution			35
Criminal Tax Cases in U. S. Courts awaiting Trial			15
Criminal Tax Convictions			6

1/ Jeopardy assessments are assessments of taxes made where a return has been filed or should have been filed, but where circumstances exist under which delay might jeopardize the collection of the revenue.

2/ Termination of tax year is a computation of the tax due and assessment made where the time for filing the return has not become due where circumstances exist under which delay might jeopardize collection of the revenue.

3/ These are assessments made as a result of seizures by other law enforcement agencies of cash or other assets against current income of narcotic traffickers where delay might jeopardize collection of the revenue.

Treasury Department
Office of Law Enforcement

June 30, 1972

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Seventeen Month Report of the Treasury/IRS Narcotics Trafficker Tax Program

During November, Treasury Agents and support personnel of the Internal Revenue Service seized and collected $2.4 million from narcotics traffickers and made assessments of $5.4 million. In addition, 68 new major targets were selected and 157 minor targets were placed under tax action.

In the Courts, 2 traffickers were convicted, and 4 indictments were returned. The Treasury has recommended an additional 11 cases for prosecution.

The additional targets expanded the program into one new state, South Dakota, and eight metropolitan areas--Aberdeen, South Dakota; Augusta, Georgia; Peoria, Illinois; Annapolis, Maryland; Reno, Nevada; Chattanooga, Tennessee; Fort Worth, Texas, and Bridgeport, Connecticut.

The 17 months result of this program are as follows:

1,175 Major Targets and 1,239 Other Traffickers

In 46 states, 82 metropolitan areas and the District of Columbia, 1,175 targets have been selected by Treasury's Target Selection Committee and referred to the IRS for intensive tax investigation (see attached Table I). Under the direction of IRS Commissioner Johnnie M. Walters, 550 Treasury Agents and 112 support personnel are presently conducting these investigations.

The Congress has passed a supplemental appropriation of $4.5 million which will increase the number of Treasury Agents to 648.

In addition, 1,239 minor targets traffickers are under tax action.

$82.5 Million Assessed--$15.6 Million Collected

$82.5 million in taxes and penalties have been assessed under the program, of which more than $15.6 million have already been collected. The drug traffickers illegal profits are being used to put them out of business (see attached Tables II and III).

20 Convictions + 44 Indictments - 61 Prosecution Recommendations = 125

Twenty men have been convicted on criminal tax charges; 44 other criminal tax cases are pending in Federal District Courts in Atlanta, Miami, Detroit, Los Angeles, San Francisco, Seattle, Boston, Indianapolis, Baltimore, and Washington, D.C., and in other areas; and another 61 investigations have been completed with prosecution recommendations (see attached Tables II and III).

SEVENTEEN MONTH REPORT
DEPARTMENT OF THE TREASURY

TABLE I

TREASURY/INTERNAL REVENUE SERVICE NARCOTICS TRAFFICKER PROGRAM

RESULTS AS OF DECEMBER 1, 1972

STATE	METROPOLITAN AREAS	TARGETS	COMPLETED INVESTIGATIONS
Alabama	Mobile	13	2
Alaska	Anchorage	1	
Arizona	Phoenix-Tucson-Yuma	61	9
Arkansas	Little Rock	3	
California	Los Angeles-San Diego	45	22
	San Francisco-Oakland	42	7
Colorado	Denver	12	2
Connecticut	Hartford-Bridgeport	16	2
Delaware	Wilmington	1	
District of Columbia	Washington	22	5
Florida	Miami-Jacksonville Tampa-Orlando	95	27
Hawaii	Honolulu	10	1
Georgia	Atlanta-Augusta	31	12
Illinois	Chicago-Springfield Peoria	61	7
Indiana	Indianapolis-Gary	12	3
Iowa	Des Moines	4	
Kansas	Lawrence	1	
Kentucky	Louisville-Covington Newport	6	
Louisiana	New Orleans	16	2
Maine	Bangor	1	
Maryland	Baltimore-Annapolis	14	3
Massachusetts	Boston	24	3
Michigan	Detroit	71	13
Minnesota	St. Paul-Minneapolis	5	

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STATE	METROPOLITAN AREAS	TARGETS	COMPLETED INVESTIGATIONS
Mississippi	Gulfport	3	
Missouri	St. Louis-Kansas City	21	8
Nebraska	Omaha	3	
Nevada	Las Vegas-Reno	5	
New Hampshire	Portsmouth	4	2
New Jersey	Newark-Camden-Trenton	67	7
New Mexico	Albuquerque	11	5
New York	Albany	14	1
	Buffalo-Rochester	20	3
	New York City	157	55
North Carolina	Greensboro-Charlotte	17	1
Ohio	Cincinnati-Dayton-Columbus	17	
	Cleveland-Toledo	24	
Oklahoma	Oklahoma City	3	
Oregon	Portland	18	4
Pennsylvania	Philadelphia	42	3
	Pittsburgh	39	6
Rhode Island	Providence	6	
South Carolina	Columbia	5	2
South Dakota	Aberdeen	1	
Tennessee	Nashville-Memphis-Chattanooga	8	
Texas	Austin-Houston-El Paso	51	11
	Dallas-Ft. Worth	8	2
Utah	Salt Lake City	6	
Virginia	Richmond-Norfolk Arlington-Alexandria	28	2
Washington	Seattle	24	5
West Virginia	Parkersburg	1	
Wisconsin	Milwaukee	5	1
		1175	239

Office of Law Enforcement
Treasury Department

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SEVENTEEN MONTH REPORT

TABLE II

Major Target Assessments:	Number	Amounts
Regular Assessments	189	$11,052,523
Jeopardy Assessments 1/	43	19,450,434
Tax Year Termination 2/	51	9,172,179
Total	283	$39,675,136
Minor Target Assessments: 3/		
Jeopardy Assessments	91	$ 2,862,639
Tax Year Termination	1148	39,997,320
Total	1239	$42,859,959
Total Assessments involving Narcotic Traffickers		$82,535,095

Collections and Seizures involving Narcotic Traffickers:

	Major Targets	Minor Targets
Currency	$3,163,904	$10,237,426
Property	141,463	2,082,999

Total Dollars Seized & Collected	$15,625,792
Cases Recommended for Prosecution	61
Criminal Tax Cases in U.S. Courts awaiting Trial	44
Criminal Tax Conviction	20
Total Criminal Cases	125

1/ Jeopardy assessments are assessments of taxes made where a return has been filed or should have been filed, but where circumstances exist under which delay might jeopardize the collection of the revenue.

2/ Termination of tax year is a computation of the tax due and assessment made where the time for filing the return has not become due where circumstances exist under which delay might jeopardize the revenue.

3/ These are assessments made as a result of seizures by other law enforcement agencies of cash or other assets against current income of narcotic traffickers where delay might jeopardize collection of the revenue.

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U. S. Treasury Department
Office of Law Enforcement

TABLE III

Metropolitan Areas	Major Target Program						Minor Target Program			
	Number	Assessments	Dollars Seized	P.R.	I.	C.	Number	Assessments	Dollars Seized	Collections
Atlanta, Ga.	14	$ 415,977	$ 28,511	5	4	0	37	$ 476,433	$ 136,797	$ 67,877
Austin-Houston-El Paso, Tex.	15	1,576,515	54,220	3	1	0	91	1,629,038	817,487	
Baltimore, Md. - Washington, D.C.	11	1,362,862		3	1	5	2	238,834	44,879	93,636
Boston, Mass.	5	5,561,815	22,183	2	1	1	67	2,132,887	542,582	
Buffalo, N.Y.	3	16,383		1	0	0	19	149,326	82,122	
Cleveland, Ohio				0	0	0	12	690,646	113,375	
Chicago-Springfield, Ill.	10	311,713	16,850	3	2	0	78	2,264,421	178,008	
Detroit, Mich.	17	1,252,166	13,555	4	3	2	69	1,310,544	367,806	692,000
Charlotte-Greensboro, N.C.	3	163,933	15,240	2	0	1	34	320,680	53,989	10,052
Miami-Jacksonville-Tampa, Fla.	32	10,183,653	1,300	2	11	4	49	762,032	593,594	142,877
Los Angeles-San Deigo, Calif.	25	915,441	59,238	4	1	1	177	10,291,836	1,325,802	
Newark-Camden-Trenton, N.J.	14	3,721,619	1,656	0	2	0	27	1,502,991	869,317	
New York City	53	7,503,738	1,621,027	10	3	1	108	7,794,275	3,766,264	
Philadelphia, Penna.	5	206,195	16,000	1	0	0	41	714,073	320,447	
Phoenix-Tucson, Ariz.	10	280,422	5,620	3	2	0	58	1,416,699	337,765	
Pittsburgh, Penna.	4	36,689	2,843	3	1	1	11	451,202	120,752	8,144
San Francisco-Oakland, Calif.	12	760,888	79,604	2	3	0	61	2,582,650	531,163	
Seattle-Tacoma, Wash.	5	137,038	35,000	1	2	1	13	224,932	122,204	
St. Louis, Mo.	9	1,019,793	5,573	2	2	2	8	247,712	27,071	
Richmond-Norfolk-Arlington, Va.	3	146,734	11,274	1	0	0	7	264,880	15,836	26,895
Other	33	4,100,742	274,114	9	5	1	270	7,393,868	1,253,073	
Totals	283	$39,675,136	$ 2,263,888	61	44	20	1239	$42,859,959	$ 12,320,425	$ 1,041,481

Dollars Seized includes both property and currency
P.R. - Cases Recommended for Prosecution
I. - Criminal Cases in U. S. Courts awaiting Trial
C. - Criminal Convictions

December 1, 1972

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May 14, 1986

The Honorable Ferdnand St. Germain
Chairman, Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing on behalf of the National Association of Criminal Defense Lawyers regarding today's subcommittee hearing on money laundering legislation.

NACDL has testified previously in the 99th Congress on a range of money laundering proposals in both Houses. Our Third Vice-President and Legislative Chairperson, Neal R. Sonnett, testified before the House Judiciary Subcommittee on Crime, on September 12, 1985, and before the full Senate Judiciary Committee on October 29, 1985, focusing on both occasions primarily on the Administration's proposed legislation (H.R. 2785, S. 1335), and on Congressman Hughes' bill (H.R. 1474). A copy of our most recent testimony, from the October 29 Senate hearing, is enclosed for the information and consideration of the Subcommittee.

We would like to supplement that testimony, however, for specific purposes of today's hearing, in the following respects:

1) Amendments to the Right to Financial Privacy Act: We wish to associate ourselves with the remarks of Jerry Berman, Chief Counsel of the ACLU, prepared for submission at today's hearing regarding such amendments, and concur with his conclusion that "the government has made no showing that the Right to Financial Privacy Act procedures present a serious impediment to law enforcement or money laundering investigations." Particularly problematic is the provision in the Administration's bill (subsection 3(f) of H.R. 2785) to delete the requirement that records obtained from a financial institution pursuant to a grand jury subpoena must be returned and actually presented to the grand jury. Presentment to the grand jury itself of records so subpoenaed is an essential safeguard against abuse of the grand jury's subpoena authority; to eliminate this requirement would be to confer upon the prosecution its own subpoena authority, and further reduce the independence of the grand jury and

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its vital, historic role as a bulwark between the accuser and the accused.

2) Position of National Association of Attorneys General: We call the Subcommittee's attention to the testimony of John Van De Camp, California Attorney General, testifying on behalf of the National Association of Attorneys General at the September 12, 1985 hearing before the House Judiciary Subcommittee on Crime. At page 17 of his statement, he expresses NAAG's opposition to the sweeping reach of the Administration's proposed money laundering legislation, particularly the use of a "reckless disregard" standard, and the breadth of the definition of the term "transaction" to include any transaction which "in any way or degree affects interstate commerce." NACDL concurs that the term should be limited to transactions involving "financial institutions," with that term narrowly defined along the lines set forth in H.R. 1474.

3) Status of attorneys' fees: One particularly compelling reason for approaching this definitional issue carefully is to avoid criminalizing the receipt by attorneys of bona fide fees for criminal defense services. The California legislature has specifically addressed this issue, in money laundering legislation approved by both Houses, through the inclusion of the following language in the bill's central provision establishing the offense of money laundering:

> In consideration of the constitutional right to counsel afforded by the Sixth Amendment to the United States Constitution and by Section 15 of Article I of the California Constitution, when a case involves an attorney who accepts a fee for representing a client in a criminal investigation or proceeding, the prosecution shall additionally be required to prove that the monetary instrument was accepted by the attorney with the intent to disguise or aid in disguising the source of the funds or the nature of the criminal activity.

[proposed new section 186.10(a) of Calif. Penal Code, as proposed to be added by section 1.5 of Assembly Bill No. 2570.] NACDL strongly endorses the addition of similar language to any federal money laundering legislation favorably reported by this Subcommittee.

4) Forfeiture of attorneys' fees: As noted in our earlier testimony, NACDL strongly opposes the proposed expansion of criminal forfeiture in the Administration's bill. Our previous discussion of the issue should be supplemented by citation to two recent U.S. District Court decisions holding unconstitutional the use of existing criminal forfeiture provisions to pursue bona fide attorneys' fees for criminal defense representation. Those decisions--U.S. v. Iannello, U.S. v. Reckmeyer, and U.S. v. Bassett--as yet unreported, are attached for the Subcommittee's convenience.

5) American Bar Association Resolution: At its mid-year meeting in February of 1986, the ABA House of Delegates by an overwhelming margin passed a resolution dealing with money laundering. This resolution, attached to the testimony offered today by Samuel Buffone on behalf of the ABA, is consistent with the position of NACDL in all significant respects--the need for a requirement that the offense be knowingly and intentionally committed, the new offense of "facilitation," the proposed amendments to Federal Rule of Criminal Procedure 17, the new offense of "receiving the proceeds of a crime," and the expanded forfeiture provisions.

I hope that these views will be helpful to the Subcommittee in considering the money laundering legislation currently before it. I would respectfully request that these materials be made a part of the record of today's proceedings, for the information and convenience of members of the full Committee and other interested Members in both Houses.

The Subcommittee's kind consideration of NACDL's views on these important matters is greatly appreciated.

Sincerely,

Scott Wallace

Scott Wallace
Legislative Director

enclosures

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